

# Financial Section

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**T**his section contains the Department's financial statements and related Independent Auditor's Report, and other information pertaining to the Department's financial management. For more information on this section, please contact the Office of Financial Policy, Reporting, and Analysis at (202) 261-8620.

## FINANCIAL AND PERSONNEL HIGHLIGHTS

(Dollars in Thousands)	% Change 2006 over 2005	2006	2005 Restated
<b>At End of Year:</b>			
<b>Condensed Balance Sheet Data:</b>			
Investments, Net	+5%	\$ 14,101,765	\$ 13,389,090
Fund Balances With Treasury	+15%	16,170,761	14,023,542
Property and Equipment, Net	+17%	9,175,917	7,862,612
Other	-43%	614,009	1,079,749
<b>Total Assets</b>	+10%	<b>\$ 40,062,452</b>	<b>\$ 36,354,993</b>
Foreign Service Retirement Actuarial <sup>1</sup>	+6%	\$ 14,215,300	\$ 13,429,300
Liability to International Organizations	-2%	1,155,344	1,178,130
Other	+2%	2,522,403	2,472,568
<b>Total Liabilities</b>	+5%	<b>17,893,047</b>	<b>17,079,998</b>
Unexpended Appropriations	+15%	13,199,766	11,430,639
Cumulative Results of Operations	+14%	8,969,639	7,844,356
<b>Total Net Position</b>	+15%	<b>22,169,405</b>	<b>19,274,995</b>
<b>Total Liabilities and Net Position</b>	+10%	<b>\$ 40,062,452</b>	<b>\$ 36,354,993</b>
<b>Full-time Personnel:</b>			
Civil Service	+2%	8,270	8,092
Foreign Service	+1%	11,397	11,238
Foreign Service National	-9%	8,189	8,964
<b>Total Full-time Personnel</b>	-2%	<b>27,856</b>	<b>28,294</b>
<b>Foreign Service Annuitants<sup>1</sup></b>	+6%	<b>15,759</b>	<b>14,842</b>
<b>For the Year:</b>			
Total Cost	+6%	\$ 16,978,441	\$ 15,953,921
Total Earned Revenue	+11%	(4,590,276)	(4,131,816)
<b>Total Net Cost of Operations</b>	+5%	<b>\$ 12,388,165</b>	<b>\$ 11,822,105</b>
<b>On-Time Payments (%)</b>	-2%	<b>94%</b>	<b>96%</b>
<b>Electronic Funds Transfer Payments (%)</b>	+2%	<b>87%</b>	<b>85%</b>

<sup>1</sup> The Department administers the operations of the Foreign Service Retirement and Disability Fund. This Fund provides annuities to retired members of the Foreign Service (or their survivors).

# Independent Auditor's Report

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United States Department of State  
and the Broadcasting Board of Governors

*Inspector General*

NOV 15 2006

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INFORMATION MEMO TO THE SECRETARY

FROM:           OIG – Howard J. Krongard 

SUBJECT:       *Independent Auditor's Report on the U.S. Department of State's  
2006 and 2005 Financial Statements* (Report AUD/FM-07-12)

In compliance with the Chief Financial Officers Act, as amended, OIG contracted with Leonard G. Birnbaum and Company, LLP (LGB), an independent certified public accounting firm, to audit the Department's financial statements as of September 30, 2006 and 2005, and for the years then ended.

The Department was unable to provide complete financial statements or respond to requests for evidential material in a timely manner, including information on the restatement of the 2005 financial statements necessitated by material amounts of real property that had not been reported properly in the 2005 financial statements. Accordingly, LGB was not able to complete its work in time to meet the November 15, 2006, deadline imposed by the Office of Management and Budget for issuing its report. The scope of LGB's work was not sufficient to enable it to express, and it did not express, an opinion on the 2006 or 2005 financial statements. Due to the restatement, LGB's opinion on the 2005 financial statements, issued December 14, 2005, should not be relied upon.

LGB also found:

- Six reportable conditions involving the Department's internal controls over the recording of personal property, the domestic information system network's vulnerability to unauthorized access, the financial and accounting system, the management of undelivered orders, the implementation of managerial cost accounting standards, and the recording of real property and related depreciation expense.

Address correspondence to: U.S. Department of State, Office of Inspector General, Washington, D.C. 20522-0308

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- Instances of noncompliance with selected provisions of applicable laws and regulations involving the Department's financial management system.
- The Department's financial management systems did not substantially comply with the Federal Financial Management Improvement Act of 1996.

LGB's report, dated November 14, 2006, is attached for your review. LGB is responsible for this report and the opinions and conclusions expressed therein. OIG is responsible for technical and administrative oversight regarding performance under the terms of the contract. OIG's review, as differentiated from an audit in accordance with *Government Auditing Standards*, was not intended to enable OIG to express, and OIG does not express, an opinion on the Department's financial statements or conclusions about the effectiveness of internal control and compliance with certain laws and regulations, including the Federal Financial Management Improvement Act.

The Bureau of Resource Management's comments are included as Appendix A to the report. In addition to this report, OIG will transmit a separate management letter discussing several other matters that were identified during the review.

OIG appreciates the cooperation extended to it and its contractors by the Department's managers and staff during its work.

Attachment: Tab 1

**LEONARD G. BIRNBAUM AND COMPANY, LLP**

CERTIFIED PUBLIC ACCOUNTANTS

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**INDEPENDENT AUDITOR'S REPORT**

To the Secretary, Department of State:

**W**e were engaged to audit the accompanying Consolidated Balance Sheet, Consolidated Statement of Net Cost, Consolidated Statement of Changes in Net Position, Combined Statement of Budgetary Resources, and Consolidated Statement of Financing (Annual Financial Statements) as of, and for the years ended, September 30, 2006 and 2005. We have examined internal control over financial reporting as of, and during the year ended, September 30, 2006, and we have examined compliance with applicable laws and regulations.

We are unable to express an opinion on the Annual Financial Statements as of, and for the year ended, September 30, 2006, because of limitations on the scope of our work. Thus, the financial statements may be unreliable. The Department was unable to provide complete financial statements or respond to requests for evidential material in a timely manner, and we were not able to perform other auditing procedures to satisfy ourselves as to the accuracy of the financial statements in time to meet the November 15, 2006, deadline imposed by the Office of Management and Budget for issuing our report. Therefore, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the 2006 financial statements.

During FY 2006, the Department became aware of material amounts of real property that had not been reported properly in its 2005 financial statements. As a result, the Department has restated 2005 balances and activity. Accordingly, our report on the Department's 2005 financial statements, dated December 14, 2005, should not be relied upon.

We are unable to express an opinion on the Annual Financial Statements as of, and for the year ended, September 30, 2005, because of limitations on the scope of our work. Thus, the financial statements may be unreliable. The Department was unable to provide complete financial statements or respond to requests for evidential material on its restatement of the 2005 financial statements in a timely manner, and we were not able to perform other auditing procedures to satisfy ourselves as to the accuracy of the financial statements in time to meet the November 15, 2006, deadline imposed by the Office of Management and Budget for issuing our report. Therefore, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the 2005 financial statements.

We found the following:

- Reportable conditions on weaknesses in the Department's internal controls.
- Instances of noncompliance with selected provisions of applicable laws and regulations involving the Department's financial management system.
- The Department's financial management systems did not substantially comply with the requirements of the Federal Financial Management Improvement Act (FFMIA) of 1996.

Each of these conclusions is discussed in more detail below. This report also discusses the scope of our work.

### ANNUAL FINANCIAL STATEMENTS

Because the Department was unable to provide complete financial statements or respond to requests for evidential material in a timely manner and we were not able to perform other auditing procedures to satisfy ourselves as to the accuracy of the 2006 financial statements in time to meet the November 15, 2006, deadline imposed by the Office of Management and Budget for issuing our report, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the financial statements as of and for the year ended September 30, 2006.

Because the Department was unable to provide complete financial statements or respond to requests for evidential material on its restatement of the 2005 financial statements (as detailed in Note 20) in a timely manner, and we were not able to perform other auditing procedures to satisfy ourselves as to the accuracy of the 2005 financial statements in time to meet the November 15, 2006, deadline imposed by the Office of Management and Budget for issuing our report, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the restated financial statements as of and for the year ended September 30, 2005.

As discussed in Note 2, in FY 2005, the Department determined that major aircraft components – high dollar value items that are repairable and in serviceable condition – should be treated as general property and equipment and as such capitalized and depreciated over the life of the asset once installed on an aircraft. In FY 2006, the Department conducted an analysis that determined that the actual useful life of such components was less than two years and, as such, did not meet the definition of general property and equipment as provided for in the Statement of Federal Financial and Accounting Standards (SFFAS) Number 6, *Accounting for Property, Plant, and Equipment*. In addition, these components do not meet the definition of inventory as provided for in SFFAS Number 3, *Accounting for Inventory and Related Property*.

### INTERNAL CONTROL

In planning and performing our audit work, we considered the Department's internal control over financial reporting. We did this to determine our procedures for auditing the financial statements and to comply with Office of Management and Budget (OMB) audit guidance. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin 06-03, *Audit Requirements for Federal Financial Statements*. We did

not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982, such as those controls relevant to ensuring efficient operations. The objective of our audit was not to provide assurance on internal control. Consequently, we do not provide an opinion on internal control.

The objectives of internal control are to provide management with reasonable, but not absolute, assurance that the following objectives are met:

- Transactions are properly recorded and accounted for to permit the preparation of reliable financial reports and to maintain accountability over assets.
- Funds, property, and other assets are safeguarded against loss from unauthorized acquisition, use, or disposition.
- Transactions, including those related to obligations and costs, are executed in compliance with laws and regulations that could have a direct and material effect on the financial statements and other laws and regulations that OMB, Department management, or the Inspector General have identified as being significant for which compliance can be objectively measured and evaluated.
- Data that support reported performance measures are properly recorded and accounted for to permit preparation of reliable and complete performance information.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters of internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of internal control that, in our judgment, could adversely affect the Department's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that errors or irregularities in amounts, which would be material in relation to the financial statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

We are required to review the Department's current Federal Managers' Financial Integrity Act report and disclose differences with the material weaknesses in our report. We did not identify any discrepancies.

We noted six matters involving internal control that we consider to be reportable conditions as follows:

- We have identified deficiencies related to the recording of personal property and related depreciation expense and accumulated depreciation. The Department does not have an adequate system of controls to identify and record property in the hands of contractors. Further, the Department's controls over vehicles and other personal property are ineffective. Our tests disclosed (1) significant discrepancies between inventories of property reported by posts and bureaus and those maintained centrally and used as a source for reporting for financial statement purposes, (2) posts not submitting inventories of property with no investigation by responsible Department officials, (3) property



not reported by posts and bureaus, (4) errors resulting from ineffective interface between IT applications related to property, and (5) errors in depreciation resulting from incorrect in-service dates.

- We have identified deficiencies related to information system security that we believe could be exploited to have a detrimental effect on the information used to prepare the financial statements. We believe that the information system networks for domestic operations are vulnerable to unauthorized access. Consequently, systems, including the Department's financial management system, that process data using these networks may also be vulnerable.

The two items above were reported as material weaknesses in our report on the 2005 financial statements.

- The Department's financial and accounting system, as of September 30, 2006, was inadequate. There is a risk of materially misstating financial information under the current conditions. This condition is a significant reason that the Department was unable to provide complete financial statements or respond to requests for evidential material in a timely manner, which led to our inability to express an opinion on the 2006 financial statements. The principal areas of inadequacy were the following:
  - Certain elements of the financial statements, including, but not limited to, personal property, capital leases, and certain accounts payable, are developed from sources other than the general ledger. The use of sources other than the general ledger to generate elements of the financial statements increases the potential for omission of significant transactions.
  - During 2006, the Department used several systems for the management of grants and other types of financial assistance. The systems lacked standard data classifications and common processes and were not integrated with the Department's centralized financial management system. Further, the Department could not produce reliable financial information that defined the universe of grants and other federal financial assistance. The Department has undertaken an initiative jointly with the U.S. Agency for International Development to establish a grants management system. Subject to funding approval, implementation of such a system is expected to begin in the FY 2007 time frame.
  - The Department is unable to produce year-end financial data to be included in its Performance and Accountability Report in a timely manner.
- The Department's internal control process related to the management of undelivered orders was inadequate. The Department has made significant improvements in this area over the past three years. The Department has actively worked with bureaus to validate undelivered orders and has successfully cleared up a significant number of obligations that were outstanding from past years. However, the Department needs to perform additional work to correct this condition. Our tests indicated that over \$400 million of undelivered orders should have been deobligated as of September 30, 2006. Also, we noted that the Department's undelivered orders balance has grown to \$10.7 billion as of September 30, 2006. The Budget and Accounting Procedures Act of 1950 requires that the Department's accounting system provide effective control over funds. Failure to deobligate funds in a timely manner may result in the loss of availability of those funds.

The above two reportable conditions were cited in our audit of the Department's 1997 financial statements and subsequent audits.

- Although the Department complied with certain aspects of SFFAS Number 4, *Managerial Cost Accounting Standards* (for instance, it chose reasonable responsibility segments, recognized the cost of goods and services that it receives from other entities, and used an appropriate allocation methodology), it did not implement an effective process to routinely collect managerial cost accounting information or establish outputs for each responsibility segment. Until this is done, we do not believe the information will be useful as a management decisionmaking tool.

The above condition was reported in our audit of the Department's 2000 financial statements and subsequent audits.

- The Department's controls related to the recording of real property and related depreciation expense and accumulated depreciation during most of FY 2006 and all of FY 2005 were inadequate, resulting in (1) significant amounts of construction costs being expensed rather than capitalized and (2) costs of completed projects not being moved from construction-in-progress on a timely basis.

These reportable conditions, although not considered material weaknesses, represent deficiencies in the design or operation of internal control, which could adversely affect any decision by management that is based, in whole or in part, on information that is inaccurate because of them. Unaudited financial information reported by the Department, including budget information, also may contain misstatements resulting from these deficiencies.

In addition, we considered the Department's internal control over Required Supplementary Information by obtaining an understanding of the Department's internal control, determining whether controls had been placed in operation, assessing control risk, and performing tests of controls as required by OMB Bulletin 06-03 and not to provide assurance on those internal controls. Accordingly, we do not provide an opinion on those controls.

Finally, with respect to internal control related to performance measures reported in Management's Discussion and Analysis, we obtained an understanding of the design of significant controls relating to the existence and completeness assertions and determined whether those controls had been placed in operation as required by OMB Bulletin 06-03. Our procedures were not designed to provide assurance on internal control over reported performance measures, and, accordingly, we do not provide an opinion on such controls.

We noted certain other internal control issues that we have reported to the Department's management in a separate letter dated November 14, 2006.

#### COMPLIANCE WITH LAWS AND REGULATIONS

The Department's management is responsible for complying with laws and regulations applicable to the Department. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the Department's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain

other laws and regulations specified in OMB Bulletin 06-03, including the requirements referred to in FFMIA. We limited our tests of compliance to these provisions, and we did not test compliance with all laws and regulations applicable to the Department. The objective of our audit of the Annual Financial Statements, including our tests of compliance with selected provisions of applicable laws and regulations, was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

Material instances of noncompliance are failures to follow requirements or violations of prohibitions in statutes and regulations that cause us to conclude that the aggregation of the misstatements resulting from those failures or violations is material to the financial statements or that sensitivity warrants disclosure thereof.

The results of our tests of compliance with the laws and regulations described above, exclusive of FFMIA, disclosed the following instances of noncompliance with laws and regulations that are required to be reported under *Government Auditing Standards*, issued by the Comptroller General of the United States, and OMB Bulletin 06-03.

Overall, we found that the Department's financial management system did not comply with a number of laws and regulations as follows:

- *Budget and Accounting Procedures Act of 1950.* This act requires an accounting system to provide full disclosure of the results of financial operations; adequate financial information needed in the management of operations and the formulation and execution of the budget; and effective control over income, expenditures, funds, property, and other assets. However, we found that the Department's financial system (1) does not provide effective control over personal property, (2) does not manage undelivered orders effectively, and (3) is unable to issue year-end financial data to be included in its PAR in a timely manner.
- *Federal Managers' Financial Integrity Act of 1982.* This act requires the implementation of internal accounting and administrative controls that provide reasonable assurance that (1) obligations and costs are in compliance with applicable laws; (2) funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and (3) revenues and expenditures applicable to Department operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the assets. However, as discussed above, we found that the Department's financial system does not provide effective control over personal property and does not manage undelivered orders effectively. Hence, these funds are not adequately protected from waste or loss.
- *Chief Financial Officers Act of 1990.* This act requires the development and maintenance of an integrated accounting and financial management system that (1) complies with applicable accounting principles, standards and requirements, and internal control standards; (2) complies with such policies and requirements as may be prescribed by the Director of OMB; (3) complies with any other requirements applicable to such systems; and (4) provides for (i) complete, reliable, consistent, and timely information that is prepared on a uniform basis and that is responsive to the financial information needs of agency management; (ii) the development and reporting of cost information; (iii) the integration of accounting and budgeting information; and (iv) the systematic measurement of performance. However, we found that the Department's financial system did not provide complete information in

that certain elements of the financial statements are developed from sources other than the general ledger, nor does the Department's financial management system produce year-end financial data to be included in its PAR in a timely manner.

- *OMB Circular A-127.* This circular requires the Department to establish and maintain an accounting system that provides for (1) complete disclosure of the financial results of the activities of the Department; (2) adequate financial information for Department management and for formulation and execution of the budget; and (3) effective control over revenue, expenditure, funds, property, and other assets. However, we found again that the financial system did not maintain effective control over personal property and undelivered orders. Further, the Department's failure to implement an effective managerial cost accounting system precludes effective control over revenues and expenditures.

The above areas of noncompliance were cited in our audit of the Department's 1997 financial statements and subsequent audits.

The results of our tests of compliance with other laws and regulations disclosed no material instances of noncompliance. Compliance with FFMIA is discussed below.

Under FFMIA, we are required to report whether the Department's financial management systems substantially comply with federal financial management system requirements, applicable accounting standards, and the U.S. Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance using the implementation guidance for FFMIA issued by OMB on January 4, 2001. OMB implementation guidance states that, to be in substantial compliance with this requirement, the Department must adhere to all applicable SFFASs; meet specific requirements of OMB Circular A-127, including the computer security controls required by OMB Circular A-130, *Management of Federal Information Resources*; and receive an unqualified opinion on its financial statements that discloses no material weaknesses in internal control that affect the Department's ability to prepare financial statements and related disclosures.

The results of our tests disclosed instances, described below, where the Department's financial management systems did not, in our view, substantially comply with the requirement to follow the federal financial management system requirements, nor did it comply with applicable accounting standards.

- SFFAS No. 4, as noted above, requires implementation of an effective process to routinely collect managerial cost accounting information and establish outputs for each responsibility segment. We found, as discussed above, that the Department had not met this requirement.
- Circular A-127 requires that the Department's systems support management's fiduciary role by providing complete, reliable, consistent, timely, and useful financial management information. Based on the deficiencies related to financial management systems discussed in the report on internal controls and the preceding paragraphs in the report on compliance with laws and regulations, we determined that the Department was not substantially in compliance with this standard.



- Circular A-130, Appendix III, requires that the Department ensure an adequate level of security for all agency automated information systems. Specifically, the Department should ensure that automated information systems operate effectively and have appropriate safeguards to ensure the integrity of those systems. Based on our concerns related to the financial management systems discussed in the report on internal control and the preceding paragraphs in the report on compliance with laws and regulations, we consider the Department to not substantially comply with this standard.

In addition, we were unable to express an opinion on the Annual Financial Statements as of, and for the years ended, September 30, 2006, because of limitations on the scope of our work. The Department was unable to provide complete financial statements or respond to requests for evidential material in a timely manner, and we were not able to perform other auditing procedures to satisfy ourselves as to the accuracy of the financial statements in time to meet the November 15, 2006, deadline imposed by the Office of Management and Budget for issuing our report.

The Department's Bureau of Resource Management (RM) has overall responsibility for the Department's financial management systems. The foregoing noncompliance has its roots in the lack of organization and integration of the Department's financial management systems. In our audits of the Department's financial statements since 1997, we observed that the Department's financial management systems were not in compliance with FFMIA and recommended, in connection with our audits of the Department's 1997 and 1998 Principal Financial Statements, that a remediation plan be prepared. RM submitted its plan to remediate noncompliance with FFMIA to OMB on March 16, 2000. Although RM has made significant progress in completing several phases of its plan, the plan has not effectively dealt with the issues related to managerial cost accounting or eliminated the deficiencies in systems security.

We noted certain other instances of noncompliance that we reported to the Department's management in a separate letter dated November 14, 2006.

### RESPONSIBILITIES AND METHODOLOGY

Department management has responsibility for the following:

- Preparing the Annual Financial Statements, required supplementary information, and other accompanying information in conformity with accounting principles generally accepted in the United States of America.
- Establishing and maintaining effective internal control.
- Complying with applicable laws and regulations.

We are responsible for obtaining reasonable assurance about whether management maintained effective internal control. We are also responsible for testing compliance with selected provisions of applicable laws and regulations that may materially affect the financial statements.

In order to fulfill these responsibilities, we took the following actions:

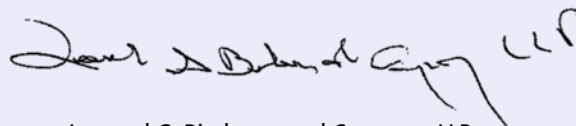
- With respect to the Department's internal control over financial reporting, we obtained an understanding of the design of internal controls, determined whether they had been placed in operation, assessed control risk, and performed tests of controls.
- With respect to performance measures included in Management's Discussion and Analysis, we obtained an understanding of the design of internal controls relating to the existence and completeness assertions and determined whether they had been placed in operation.
- We obtained an understanding of the process by which the agency identifies and evaluates weaknesses required to be reported under FMFIA and related agency implementing procedures.
- We tested compliance with selected provisions of laws and regulations that may have a direct and material effect on the financial statements.
- We performed other procedures as we considered appropriate under the circumstances.

We performed our work in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in the *Government Auditing Standards*, and the provisions of OMB Bulletin 06-03. We considered the limitations on the scope of our work in forming our conclusions.

The Management's Discussion and Analysis and Required Supplementary Information are supplementary information required by OMB Circular A-136, *Financial Reporting Requirements*, and the Federal Accounting Standards Advisory Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

This report is intended for the information of the Inspector General of the U.S. Department of State, the Department's management, OMB, and the Congress. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

Comments by the Department's management on this report are presented as Appendix A.



Leonard G. Birnbaum and Company, LLP  
Alexandria, Virginia

November 14, 2005



United States Department of State

Assistant Secretary and Chief Financial Officer

Washington, D.C. 20520

NOV 15 2006

MEMORANDUM

TO: OIG – Mr. Howard J. Krongard

FROM: RM – Bradford R. Higgins

SUBJECT: Draft Audit Report on the Department of State's 2006 and 2005 Financial Statements

This is in response to your request for comments on the draft report titled "Audit of the U.S. Department of State 2006 and 2005 Financial Statements" (Report).

The Department is committed to effective internal controls. Throughout 2006 we worked closely with the Independent Auditor to address the material weaknesses in accounting for personal property and information systems security reported in their FY 2005 *Independent Auditor's Report*. As a result, and as reflected in the Report, the Independent Auditor downgraded these items to a reportable condition, and reports no material weaknesses in internal controls.

To strengthen internal controls in 2006, the Department committed to, and fully implemented, the requirements of Appendix A, Internal Control over Financial Reporting, of OMB Circular A-123. During the implementation of Appendix A, and other work during FY 2006, Department management identified a material weakness related to accounting for real property construction-in-progress. Recognizing the severity of the deficiency, the Department developed more detailed procedural guidance for establishing projects to ensure construction costs are properly capitalized, and implemented monitoring controls for both project establishment and project completion. As a result of the corrective actions taken, the material weakness was resolved by September 30, 2006.

Unfortunately, due to the complexity of the matters involved in addressing the real property deficiencies, the accelerated financial reporting requirements, and our commitment and focus to successfully resolve the material weaknesses noted above, the Department was unable to provide timely financial statements or documentation on the appropriateness of the associated restatement to satisfy the Independent Auditor with regard to the presentation of real property in time for this Report. As a result and as more fully explained in the *Independent*

*Auditor's Report*, the independent auditors issued a disclaimer of opinion on our FY 2006 and restated FY 2005 financial statements. We are committed to continuing to work with the Independent Auditor on this issue until such time as they can satisfy themselves about the amounts presented as real property, and other accounts as necessary.

In relation to internal controls, the Report cites six reportable conditions in (1) the recording and related depreciation of personal property, (2) the Department's security of information systems networks, (3) the inadequacy of the Department's financial management systems, (4) the management of unliquidated obligations, (5) the recording and related depreciation of real property, and (6) the implementation of Managerial Cost Accounting Standards. The Department's financial management systems are also reported as noncompliant with laws and regulations, including the Federal Financial Management Improvement Act of 1996 (FFMIA). Each of the matters identified in the *Independent Auditor's Report* will be addressed as well as other deficiencies noted during their audit.

In October 2005, the Department's Management Control Steering Committee (MCSC) – the body charged with overseeing the Department's management control program under the Federal Managers' Financial Integrity Act (FMFIA) — created a subcommittee to address the weaknesses in personal property. In 2006, improvements were implemented in the methods used to identify and report armored vehicle costs, aircraft, property held by contractors, and Department-owned vehicles. In 2007, the MCSC and senior Department management will ensure that efforts continue to further strengthen the controls over the accounting for personal property.

For information systems security, the Department remains intensely aware of the value and sensitivity of its information and information systems and is dedicated to the vigilance required to ensure their adequate protection. Accordingly, the

Department continues to monitor this area through the MCSC. In FY 2007, in addition to improved certification and accreditation processes, our efforts will focus on obtaining a clear inventory of systems, addressing the many new OMB and NIST system requirements, patch management, and ensuring the Department has the latest versions of protections in place.

Compliance with Federal financial systems requirements remains a top priority. In 2006, the MCSC voted unanimously to categorize this issue as a financial system deficiency, a significant improvement from its long-standing status as a material or reportable non-conformance. In 2007, domestic users will be converted to the same platform and software that services overseas users, thereby establishing the Global Financial Management System (GFMS). As part of the GFMS implementation, the most up-to-date module for accounting for fixed assets will be installed, and a new data warehouse is being built that will provide for better reporting capabilities for users.



To improve the management of grants and other types of financial assistance, the Department is developing, in collaboration with USAID, the Joint Assistance Management System (JAMS). JAMS will provide the capability to centrally track and manage Federal financial assistance issued by the Department. The Department plans to conduct a pilot phase in 2007, followed by deployment through 2008.

Strengthening the management of undelivered orders (UDOs) is an important financial management initiative. The Independent Auditor's Report notes that there have been improvements in this area, and we continue our efforts to establish adequate processes and controls. New capabilities in the Department's Central Financial Management System allow for the automatic deobligation of UDOs based on a wide range of criteria (e.g., age, object class, dollar amount). In addition, as part of our efforts on the President's Management Agenda Initiative for Improved Financial Performance, we chart and report on the percentage of UDOs with no activity for the past 12 months. These actions have resulted in the deobligation of thousands of items with a value exceeding \$200 million during 2006. The Department continues to make progress in implementing Managerial Cost Accounting Standards (MCAS), but acknowledges that additional work is needed to substantially comply with these standards. In 2005, the Department

established a project team, which includes consultants with experience implementing Cost Accounting Systems. In 2006, the team surveyed other agencies and organizations for lessons learned and best practices; conducted an assessment of offices to determine business needs for cost information, current cost accounting practices, outputs and outcomes, and unmet needs; evaluated a managerial cost software module and confirmed usability; and developed a strategic approach and implementation strategy. In 2007, the team will conduct pilots to test the strategy, to be followed by a phased implementation department-wide.

We thank you for the opportunity to comment on the draft report. We would also like to extend our appreciation to your staff and to your contractor, Leonard G. Birnbaum and Company, LLP, for the professional and collaborative manner in which they conducted the audit. We believe considerable progress on a number of matters has been made over the past year, and the Department remains committed to improving the management of its programs and the quality of its financial reporting.

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# Financial Statements

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## INTRODUCTION TO PRINCIPAL FINANCIAL STATEMENTS

The Principal Financial Statements (Statements) have been prepared to report the financial position and results of operations of the U.S. Department of State (Department). The Statements have been prepared from the books and records of the Department in accordance with formats prescribed by the Office of Management and Budget (OMB) in OMB Circular A-136, *Financial Reporting Requirements*. The Statements are in addition to financial reports prepared by the Department in accordance with OMB and U.S. Department of the Treasury (Treasury) directives to monitor and control the status and use of budgetary resources, which are prepared from the same books and records. The Statements should be read with the understanding that they are for a component of the U.S. Government, a sovereign entity. The Department has no authority to pay liabilities not covered by budgetary resources. Liquidation of such liabilities requires enactment of an appropriation. Comparative data for 2005 are included.

The **Consolidated Balance Sheet** provides information on assets, liabilities, and net position similar to balance sheets reported in the private sector. Intra-departmental balances have been eliminated from the amounts presented.

The **Consolidated Statement of Net Cost** reports the components of the net costs of the Department's operations for the period. The net cost of operations consists of the gross cost incurred by the Department less any exchange (i.e., earned) revenue from our activities. Intra-departmental balances have been eliminated from the amounts presented.

The **Consolidated Statement of Changes in Net Position** reports the beginning net position, the transactions that affect net position for the period, and the ending net position. Intra-departmental transactions have been eliminated from the amounts presented.

The **Combined Statement of Budgetary Resources** provides information on how budgetary resources were made available and their status at the end of the year. Information in this statement is reported on the budgetary basis of accounting. Intra-departmental transactions have not been eliminated from the amounts presented.

The **Consolidated Statement of Financing** reports the relationship between budgetary transactions and financial transactions.

**Required Supplementary Information** contains a Combining Schedule of Budgetary Resources that provides additional information on amounts presented in the **Combined Statement of Budgetary Resources**, and information on Stewardship Plant, Property and Equipment.



## PRINCIPAL FINANCIAL STATEMENTS

DEPARTMENT OF STATE  
CONSOLIDATED BALANCE SHEET

(Dollars in Thousands)

As of September 30,	Notes	2006	2005 (Restated)
<b>ASSETS</b>	3		
Intragovernmental Assets:			
Fund Balances With Treasury	4	\$ 16,170,761	\$ 14,023,542
Investments, Net	5	14,101,765	13,573,857
Accounts Receivable, Net	6	344,038	599,191
Total Intragovernmental Assets		30,616,564	28,196,590
Accounts and Loans Receivable, Net	6	34,319	70,357
Cash and Other Monetary Assets	7	48,666	159,202
Property and Equipment, Net	8	9,175,917	7,862,612
Other Assets	9	186,986	66,232
<b>Total Assets</b>		<b>\$ 40,062,452</b>	<b>\$ 36,354,993</b>
Stewardship PP&E	8		
<b>LIABILITIES</b>	10		
Intragovernmental Liabilities:			
Accounts Payable		\$ 3,473	\$ 814
Other Liabilities		316,271	26,374
Total Intragovernmental Liabilities		319,744	27,188
Accounts Payable		1,250,204	1,268,980
Foreign Service Retirement Actuarial Liability	11	14,215,300	13,429,300
Liability to International Organizations	12	1,155,344	1,178,130
Environmental Liabilities	10	392,300	392,300
Other Liabilities	10,13	560,155	784,100
<b>Total Liabilities</b>		<b>17,893,047</b>	<b>17,079,998</b>
Commitments and Contingencies	14		
<b>NET POSITION</b>			
Unexpended Appropriations		13,199,766	11,430,639
Cumulative Results of Operations—Earmarked Funds	15	(19,824)	
Cumulative Results of Operations—Other Funds		8,989,463	7,844,356
<b>Total Net Position</b>		<b>22,169,405</b>	<b>19,274,995</b>
<b>Total Liabilities and Net Position</b>		<b>\$ 40,062,452</b>	<b>\$ 36,354,993</b>

The accompanying notes are an integral part of this financial statement.

DEPARTMENT OF STATE  
CONSOLIDATED STATEMENT OF NET COST (NOTE 16)

(Dollars in Thousands)

As of September 30,

	2006	2005 (Restated)
<b>Achieve Peace and Security</b>		
<b>Regional Stability</b>		
Total Cost	\$ 1,285,178	\$ 1,355,089
Earned Revenue	(111,911)	(77,898)
Net Program Costs	1,173,267	1,277,191
<b>Counterterrorism</b>		
Total Cost	1,021,966	1,077,557
Earned Revenue	(88,991)	(61,943)
Net Program Costs	932,975	1,015,614
<b>Homeland Security</b>		
Total Cost	625,132	659,137
Earned Revenue	(54,435)	(37,891)
Net Program Costs	570,697	621,246
<b>Weapons of Mass Destruction</b>		
Total Cost	584,173	615,949
Earned Revenue	(50,869)	(35,409)
Net Program Costs	533,304	580,540
<b>International Crime and Drugs</b>		
Total Cost	2,134,302	1,895,084
Earned Revenue	(388,705)	(418,888)
Net Program Costs	1,745,597	1,476,196
<b>American Citizens</b>		
Total Cost	2,380,822	2,295,802
Earned Revenue	(2,332,238)	(1,990,390)
Net Program Costs	48,584	305,412
<b>Advance Sustainable Development and Global Interests</b>		
<b>Democracy and Human Rights</b>		
Total Cost	631,846	666,216
Earned Revenue	(55,020)	(38,298)
Net Program Costs	576,826	627,918
<b>Economic Prosperity and Security</b>		
Total Cost	1,032,707	1,088,886
Earned Revenue	(89,926)	(62,596)
Net Program Costs	942,781	1,026,290
<b>Social and Environment Issues</b>		
Total Cost	284,699	300,187
Earned Revenue	(24,791)	(17,256)
Net Program Costs	259,908	282,931
<b>Humanitarian Response</b>		
Total Cost	1,877,088	1,034,885
Earned Revenue	(122)	(51)
Net Program Costs	1,876,966	1,034,834
<b>Promote International Understanding</b>		
<b>Public Diplomacy and Public Affairs</b>		
Total Cost	1,638,788	1,765,229
Earned Revenue	(165,591)	(122,055)
Net Program Costs	1,473,197	1,643,174
<b>Executive Direction and Other Costs Not Assigned</b>		
Total Cost	3,481,740	3,199,900
Earned Revenue	(1,227,677)	(1,269,141)
Net Program Costs	2,254,063	1,930,759
<b>Total Cost</b>	<b>16,978,441</b>	<b>15,953,921</b>
<b>Total Revenue</b>	<b>(4,590,276)</b>	<b>(4,131,816)</b>
<b>Total Net Cost</b>	<b>\$ 12,388,165</b>	<b>\$ 11,822,105</b>

The accompanying notes are an integral part of this financial statement.

DEPARTMENT OF STATE  
**CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION**

(Dollars in Thousands)

For the Year Ended September 30	2006			2005 (Restated)
	Earmarked Funds	All Other Funds	Consolidated Total	Consolidated Total
<b>Cumulative Results of Operations</b>				
Beginning Balances	\$ 232,262	\$ 7,612,094	\$ 7,844,356	\$ 6,312,138
Adjustments:				
Corrections of errors			–	456,975
Beginning balance, as adjusted	232,262	7,612,094	7,844,356	6,769,113
<b>Budgetary Financing Sources:</b>				
Other Adjustments	–	555	555	
Appropriations Used	–	14,266,159	14,266,159	13,584,128
Non-exchange Revenue	2,827	24,903	27,730	17,639
Donations and Forfeitures of Cash and Cash Equivalents	6,346	1,473	7,819	4,246
Transfers in/out without Reimbursement (+/-) Other	4,936	(910,315)	(905,379)	(828,137)
<b>Other Financing Sources (Non-Exchange):</b>				
Imputed Financing From Costs Absorbed by Others	–	116,564	116,564	119,472
Total Financing Sources	14,109	13,499,339	13,513,448	12,897,348
Net Cost of Operations +/-	(266,195)	(12,121,970)	(12,388,165)	(11,822,105)
Net Change	(252,086)	1,377,369	1,125,283	1,075,243
<b>Cumulative Results of Operations</b>	<b>(19,824)</b>	<b>8,989,463</b>	<b>8,969,639</b>	<b>7,844,356</b>
<b>Unexpended Appropriations:</b>				
Beginning Balance		11,430,639	11,430,639	9,279,214
<b>Budgetary Financing Sources:</b>				
Appropriations Received		16,129,704	16,129,704	15,526,920
Appropriations transferred in/out		191,963	191,963	529,997
Other Adjustments		(286,381)	(286,381)	(321,364)
Appropriations Used		(14,266,159)	(14,266,159)	(13,584,128)
Total Budgetary Financing Sources	0	1,769,127	1,769,127	2,151,425
Total Unexpended Appropriations	0	13,199,766	13,199,766	11,430,639
<b>Net Position</b>	<b>\$ (19,824)</b>	<b>\$ 22,189,229</b>	<b>\$ 22,169,405</b>	<b>\$ 19,274,995</b>

The accompanying notes are an integral part of this financial statement.

DEPARTMENT OF STATE

**COMBINED STATEMENT OF BUDGETARY RESOURCES (NOTE 17)**

(Dollars in Thousands)

**For the Year Ended September 30,**

**2006**

**2005**

**Budgetary Resources:**

Unobligated Balance, brought forward, October 1:	\$ 4,271,107	\$ 3,473,333
Recoveries of Prior Year Unpaid Obligations	834,868	1,119,164
Budget Authority:		
Appropriations	17,370,186	16,747,367
Borrowing Authority	378	306
Contract Authority	-	-
Spending authority from offsetting collections (gross):		
Earned		
Collected	4,693,095	4,099,439
Change in receivable from Federal sources	(521,627)	239,257
Change in unfilled customer orders:		
Advance received	264,239	(16)
Without Advance from Federal Sources	(750)	1,565
Anticipated for rest of year, without advance	-	-
Previously unavailable	-	-
Expenditure transfers from trust funds:	-	-
Nonexpenditure transfers, net, anticipated and actual	191,226	295,204
Temporarily not available pursuant to Public Law	(376,869)	(712,349)
Permanently not available	(292,892)	(305,616)

**Total Budgetary Resources**

**\$ 26,432,961**

**\$ 24,957,654**

**Status of Budgetary Resources:**

Obligations Incurred:		
Direct	\$ 16,095,192	\$ 16,749,740
Reimbursable	5,050,621	3,936,808
Unobligated balance		
Apportioned	4,762,140	3,850,488
Exempt from apportionment	40,863	10,415
Unobligated balance not available	484,145	410,203

**Total Status of Budgetary Resources**

**\$ 26,432,961**

**\$ 24,957,654**



## DEPARTMENT OF STATE

**COMBINED STATEMENT OF BUDGETARY RESOURCES (NOTE 17) (continued)**

(Dollars in Thousands)

For the Year Ended September 30,	2006	2005
<b>Change in Obligated Balance:</b>		
Obligated Balance, net		
Unpaid Obligations, brought forward, October 1	10,279,062	9,239,391
Less: Uncollected customer payments from Federal sources, brought forward, October 1	(938,570)	(686,730)
Obligations incurred, net	21,145,813	20,686,548
Less: Gross Outlays	(19,394,984)	(18,534,808)
Obligated balance transfers, net		
Actual transfers, unpaid obligations	-	-
Actual transfers, uncollected customer payments from Federal sources	-	-
Less: Recoveries of prior-year unpaid obligations, actual	(834,868)	(1,119,164)
Change in uncollected customer payments from federal sources	522,378	(244,744)
Obligated balance, net, end of period:		
Unpaid obligations	11,195,023	10,279,062
Less: Uncollected customer payments from Federal sources	(416,192)	(938,569)
Net Outlays		
Gross outlays	19,394,984	18,534,808
Less: Offsetting collections	(4,957,334)	(4,095,501)
Less: Distributed Offsetting receipts	(250,820)	(247,958)
<b>Net Outlays</b>	<b>\$ 14,186,830</b>	<b>\$ 14,191,349</b>

The accompanying notes are an integral part of this financial statement.

DEPARTMENT OF STATE

**CONSOLIDATED STATEMENT OF FINANCING (NOTE 18)**

(Dollars in Thousands)

**For the Year Ended September 30,**

	<b>2006</b>	<b>2005 (Restated)</b>
<b>Resources Used to Finance Activities:</b>		
<b>Budgetary Resources Obligated</b>		
Obligations Incurred	\$ 21,145,813	\$ 20,686,548
Less: Spending Authority from offsetting collections and recoveries	(5,269,825)	(5,459,409)
Obligations net of offsetting collections and recoveries	15,875,988	15,227,139
Less: Offsetting receipts	(250,820)	(247,958)
Net obligations	15,625,168	14,979,181
<b>Other Resources</b>		
Donations	\$ 7,819	\$ 4,246
Transfers in/out without reimbursement	(905,379)	(828,137)
Imputed financing from costs absorbed by others	116,564	119,472
Net other resources used to finance activities	(780,996)	(704,419)
<b>Total Resources used to Finance Activities</b>	<b>\$ 14,844,172</b>	<b>14,274,762</b>
<b>Resources Used to Finance Items not Part of Net Cost of Operations:</b>		
Change in budgetary resources obligated for goods, services, and benefits ordered but not yet received	1,399,908	1,033,731
Resources that fund expenses recognized in prior periods	56,908	7,882
Budgetary offsetting collections and receipts that do not affect net cost of operations		
Credit program collections which increase liabilities for loan guarantees or allowances for subsidy	1,480	1,313
Other	7,842	5,517
Resources that finance the acquisition of assets	1,775,898	1,648,639
Other resources or adjustments to net obligated resources that do not affect net cost of operations	384	23,994
<b>Total Resources used to Finance Items not Part of the Net Cost of Operations</b>	<b>3,242,420</b>	<b>2,721,076</b>
<b>Total Resources Used to Finance the Net Cost of Operations</b>	<b>\$ 11,601,752</b>	<b>\$ 11,553,686</b>

The accompanying notes are an integral part of this financial statement.

## DEPARTMENT OF STATE

**CONSOLIDATED STATEMENT OF FINANCING (NOTE 18) (continued)**

(Dollars in Thousands)

**For the Year Ended September 30,**

	<b>2006</b>	<b>2005 (Restated)</b>
<b>Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:</b>		
Components requiring or generating resources in future periods		
Increase in annual leave liability	\$ 13,548	\$ 12,524
Increase in actuarial liability	786,007	111,400
Increase in contingent liabilities	—	186,300
Other, net	1,070	344,240
Total components of Net Cost of Operations that will require or generate resources in future periods	800,625	654,464
<b>Components not Requiring or Generating Resources:</b>		
Depreciation and Amortization	\$ 584,732	\$ 597,809
Revaluation of assets or liabilities	30,350	(2,073)
Other	(629,294)	(981,781)
Total components of Net Cost of Operations that will not require or generate resources	(14,212)	(386,045)
<b>Total Components of Net Cost of Operations that will not Require or Generate Resources in the Current Period</b>	<b>786,413</b>	<b>268,419</b>
<b>Net Cost of Operations</b>	<b>\$ 12,388,165</b>	<b>\$ 11,822,105</b>

The accompanying notes are an integral part of this financial statement.

## NOTES TO PRINCIPAL FINANCIAL STATEMENTS

## ORGANIZATION

Congress established the U.S. Department of State ("Department of State" or "Department"), the senior executive department of the United States Government in 1789, replacing the Department of Foreign Affairs, which was established in 1781. The Department advises the President in the formulation and execution of foreign policy. As head of the Department, the Secretary of State is the President's principal advisor on foreign affairs.



## 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

*Reporting Entity and Basis of Consolidation*

The accompanying principal financial statements (statements) present the financial activity for the Department of State. The statements include the accounts of all funds under Department control that have been established and maintained to account for the resources entrusted to Department management, or for which the Department acts as a fiscal agent or custodian.

*Basis of Presentation and Accounting*

The accompanying statements are prepared as required by the Government Management and Reform Act (GMRA) of 1994 and presented in accordance with form and content requirements contained in Office of Management and Budget (OMB) Circular A-136, Financial Reporting Requirements, as amended.

The statements have been prepared from the Department's books and records, and are in accordance with the Department's accounting policies (the significant policies are summarized below in this Note). The Department's accounting policies follow accounting principles generally accepted in the United States of America (GAAP). GAAP for Federal entities is the hierarchy of accounting principles prescribed in the American Institute of Certified Public Accountants' Statement of Auditing Standards No. 91, Federal GAAP Hierarchy, which is also incorporated in OMB Circular A-136.

Transactions are recorded on both an accrual and budgetary basis. Budgetary accounting facilitates compliance with legal constraints and controls over the use of Federal funds:

*Use of Estimates*

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions, and exercise judgment that affects the reported amounts of assets, liabilities and net position and disclosure of contingent liabilities as of the date of the financial statements, and the reported amounts of revenues, financing sources, expenses and obligations incurred during the reporting period. These estimates are based on management's best knowledge of current events, historical experience, actions the Department may take in the future, and on various other assumptions that are believed to be reasonable under the circumstances. Due to the size and complexity of many of the Department's programs, the estimates are subject to a wide range of variables, including assumptions on future economic and financial events. Accordingly, actual results could differ from those estimates.

**Revenues and Other Financing Sources**

Department operations are financed through appropriations, reimbursement for the provision of goods or services to other Federal agencies, proceeds from the sale of property, certain consular-related and other fees, and donations. In addition, the Department collects passport, visa, and other consular fees that are not retained by the Department but are deposited directly to a Treasury account. The passport and visa fees are reported as earned revenues on the Statement of Net Cost and as a transfer-out of financing sources on the Statement of Changes in Net Position.

Congress annually enacts one-year and multi-year appropriations that provide the Department with the authority to obligate funds within the respective fiscal years for necessary expenses to carry out mandated program activities. In addition, Congress enacts multi-year appropriations and appropriations that are available until expended. All appropriations are subject to OMB apportionment as well as Congressional restrictions. For financial statement purposes, appropriations are recorded as a financing source (i.e., Appropriations Used) and reported on the Statement of Changes in Net Position at the time they are recognized as expenditures. Appropriations expended for capitalized property and equipment are recognized when the asset is purchased.

Work performed for other Federal agencies under reimbursable agreements is financed through the account providing the service and reimbursements are recognized as revenue when earned. For example, administrative support services at overseas posts are provided to other Federal agencies through the International Cooperative Administrative Support Services (ICASS). ICASS bills for the services it provides to agencies at overseas posts. These billings are recorded as revenue to ICASS and must cover overhead costs, operating expenses, and replacement costs for capital assets needed to carry on the operation.

Proceeds from the sale of real property, vehicles, and other personal property are recognized as revenue when the proceeds are credited to the account from which the asset was funded. For non-capitalized property, the full amount realized is recognized as revenue. For capitalized property, revenue or loss is determined by whether the proceeds received were more or less than the net book value of the asset sold. The Department retains proceeds of sale, which are available for purchase of the same or similar category of property.

The Department is authorized to collect and retain certain user fees for machine-readable visas, expedited passport processing, and fingerprint checks on immigrant visa applicants. The Department is also authorized to credit the respective appropriations with (1) fees for the use of Blair House; (2) lease payments and transfers from the International Center Chancery Fees held in Trust to the International Center Project; (3) registration fees for the Office of Defense Trade Controls; (4) reimbursement for international litigation expenses; and (5) reimbursement for training foreign government officials at the Foreign Service Institute.

Generally, donations received in the form of cash or financial instruments are recognized as revenue at their fair value in the period received. Contributions of services are recognized if the services received (a) create or enhance non-financial assets, or (b) require specialized skills that are provided by individuals possessing those skills, which would typically need to be purchased if not donated. Works of art, historical treasures, and similar assets that are added to collections are not recognized at the time of donation. If subsequently sold, proceeds from the sale of these items are recognized in the year of sale.

The Department receives most of the funding it needs to support the Repatriation Loan Program through an annual appropriation and permanent, indefinite borrowing authority. The appropriation has two components: (1) a subsidy portion for the present value of long-term cash flow, and (2) estimated expenses to administer the program. Appropriations are recognized as used at the time the loans are obligated and administrative expenses are incurred.



***Fund Balances with Treasury***

The Fund Balances with Treasury are available to pay accrued liabilities and finance authorized commitments relative to goods, services, and benefits. The Department does not maintain cash in commercial bank accounts for the funds reported in the Consolidated Balance Sheet, except for the Emergencies in the Diplomatic and Consular Services, Office of Foreign Missions, Foreign Service National Defined Contributions Retirement Fund, and the International Center. Treasury processes domestic receipts and disbursements. The Department operates two Financial Service Centers, which are located in Bangkok, and Charleston, South Carolina, and provide financial support for the Department and other Federal agencies' operations overseas. The U.S. Disbursing Officer at each Center has the delegated authority to disburse funds on behalf of the Treasury.

***Accounts and Loans Receivable***

Intragovernmental Accounts Receivable are due principally from other Federal agencies for ICASS services, reimbursable agreements, and Working Capital Fund (WCF) services. Accounts and Loans Receivable from non-Federal entities are primarily the result of International Boundary and Water Commission (IBWC) receivables for Mexico's share of IBWC activities and Repatriation Loans. The Department provides Repatriation Loans for destitute American citizens overseas whereby the Department becomes the lender of last resort. These loans provide assistance to pay for return transportation, food and lodging, or medical expenses. The borrower executes a promissory note without collateral. Consequently, the loans are made anticipating a low rate of recovery. Interest, penalties, and administrative fees are assessed if the loan becomes delinquent.

Accounts and Loans Receivable from non-Federal entities are subject to the full debt collection cycle and mechanisms, e.g., salary offset, referral to collection agents, and Treasury offset. In addition, Accounts Receivable from non-Federal entities are assessed interest, penalties and administrative fees if they become delinquent. Interest and penalties are assessed at the Current Value of Funds Rate established by Treasury. Accounts Receivable is reduced to net realizable value by an Allowance for Uncollectable Accounts.

***Advances and Prepayments***

Payments made in advance of the receipt of goods and services are recorded as advances or prepayments, and recognized as expenses when the related goods and services are received. Advances are made principally to Department employees for official travel, miscellaneous prepayments and advances to other entities for future services, and salary advances to Department employees transferring to overseas assignments. Advances and prepayments are reported as Other Assets on the Balance Sheet.

***Valuation of Investments***

The Department has several accounts that have the authority to invest cash resources (see Note 5 "Investments"). For these accounts, the cash resources not required to meet current expenditures are invested in interest-bearing obligations of the U.S. Government. These investments consist of U.S. Treasury special issues and securities. Special issues are unique public debt obligations for purchase exclusively by the Foreign Service Retirement and Disability Fund and for which interest is computed and paid semi-annually on June 30 and December 31. They are purchased and redeemed at par which is their carrying value on the Consolidated Balance Sheet.

Investments by the Department's Gift, Israeli-Arab Scholarship, Eisenhower Exchange Fellowship and Middle-Eastern-Western Dialogue accounts are in U.S. Treasury securities. Interest on these investments is paid semi-annually at various rates. These investments are reported at acquisition cost, which equals the face value net of unamortized discounts or premiums. Discounts and premiums are amortized over the life of the security using the straight-line method for Gift Funds investments, and effective interest method for the other accounts.

### **Inventories**

Inventories are reported as Other Assets on the Department's Consolidated Balance Sheet and include inventories held by WCF's Publishing Services, and the Supply Services Center and Stock Account. The WCF inventory consists primarily of paper and ink used for printing and reproduction services (Publishing Services), furniture held for sale to bureaus in the Department (Supply Services Center and Stock Account), and publications held for sale.

The WCF's Publishing Services inventory is valued at the latest acquisition cost. The Supply Services Center and Stock Account inventory is valued monthly using a weighted moving average. The inventory value of the publications held for sale is based on the cost of production. Recorded values are adjusted for the results of periodic physical inventories.

### **Property and Equipment**

#### **Real Property**

Real property assets primarily consist of facilities used for U.S. diplomatic missions abroad and capital improvements to these facilities, including unimproved land; residential and functional-use buildings such as embassy/consulate office buildings; office annexes and support facilities; and construction-in-progress. Title to these properties is held under various conditions including fee simple, restricted use, crown lease, and deed of use agreement. Some of these properties are considered historical treasures and multi-use heritage assets. These items are reported on the Balance Sheet, in Note 8 (Stewardship PP&E) to the financial statements, and included in the Required Supplementary Information—Heritage Assets.

The Department also owns several domestic real properties, including the National Foreign Affairs Training Center (Arlington, VA); the International Center (Washington, D.C.); the Charleston Financial Services Center (S.C.); the Beltsville Information Management Center (Md.); the Florida Regional Center (Ft. Lauderdale); and consular centers in Charleston (S.C.); Portsmouth (N.H.) and Williamsburg (K.Y.). The International Boundary and Water Commission (IBWC) has buildings and structures related to its boundary preservation, flood control, and sanitation programs.

Buildings and structures are carried at either actual or estimated historical cost. The Department capitalizes all costs for constructing new buildings and building acquisitions regardless of cost, and capitalizes all other improvements greater than \$250,000. Costs incurred for constructing new facilities, major rehabilitations, or other improvements in the design or construction stage are recorded as Construction-in-Progress. After these projects are completed, costs are transferred to Buildings and Structures or Leasehold Improvements as appropriate. Depreciation of buildings and other structures is computed on a straight-line basis, principally over a 30-year period.



*The Tangier Old Legation, the first property that the United States Government acquired for a diplomatic mission, was presented as a gift to the American people by Sultan Moulay Suliman in 1821.*

## Personal Property

Personal property consists of several asset categories including aircraft, vehicles, security equipment, communication equipment, ADP equipment, reproduction equipment, and software. The Department holds title to these assets, some of which are operated in unusual conditions as described below.



The Department's Bureau of International Narcotics and Law Enforcement (INL) uses aircraft to help eradicate and stop the flow of illegal drugs. To accomplish its mission, INL maintains an aircraft fleet that is the second largest federal, nonmilitary fleet. Most of the aircraft are under direct INL airwing management. However, a number of aircraft are managed by host-countries. The Department owns title to the aircraft under these programs and is prohibited from giving title for any aircraft to foreign governments without Congressional approval. As such, these host-country managed aircraft are, for the most part, no-cost, long-term leases. INL contracts with firms to provide maintenance support depending on whether the aircraft are INL airwing or host-country managed. INL airwing managed aircraft are maintained to FAA standards that involves routine inspect, replace as necessary activity as well as scheduled maintenance and replacement of certain parts after given hours of use. Host-country managed aircraft are maintained to host-country requirements, which are less than FAA standards.

The Department maintains a large vehicle fleet that operates overseas. Many vehicles require armoring for security reasons, and for some locations large utility vehicles are used instead of conventional sedans. In addition, the Department contracts with firms to provide support in strife-torn areas such as Iraq, Afghanistan and Darfur. The contractor support includes the purchase and operation of armored vehicles. Under the terms of the contracts, the Department has title to the contractor-held vehicles.

Personal property and equipment with an acquisition cost of \$25,000 or more, and a useful life of two or more years, is capitalized at cost. However, there are exceptions to this capitalization policy. All vehicles are capitalized, as well as ADP software costing over \$500,000. Except for contractor-held vehicles in Iraq and Afghanistan, depreciation is calculated on a straight-line basis over the asset's estimated life and begins when the property is put into service. Contractor-held vehicles in Iraq and Afghanistan, due to the harsh operating conditions, are depreciated on a double-declining balance basis. The estimated useful lives are as follows:

Asset Category	Estimated Useful Life
Aircraft:	
INL airwing managed	10 years
Host-country managed	5 years
Vehicles:	
Department managed	3 to 6 years
Contractor-held in Iraq and Afghanistan	2 ½ years
Security Equipment	3 to 15 years
Communication Equipment	3 to 20 years
ADP Equipment	3 to 6 years
Reproduction Equipment	3 to 15 years
Software	Lesser of estimated useful life or 7 years

**Capital Leases**

Leases are accounted for as capital leases if they meet one of the following criteria: (1) the lease transfers ownership of the property by the end of the lease term; (2) the lease contains an option to purchase the property at a bargain price; (3) the lease term is equal to or greater than 75% of the estimated useful life of the property; or (4) the present value of the minimum lease payment equals or exceeds 90% of the fair value of the leased property. The initial recording of the lease's value (with a corresponding liability) is the lesser of the net present value of the lease payments or the fair value of the leased property. Capital leases are amortized over the term of the lease.

**Works of Art and High Value Furnishings**

See Note 8 "Property and Equipment – Stewardship PP&E," on pages 286 to 287 for the Department's policy for works of art and high value furnishings.

**Grants**

The Department awards educational, cultural exchange, and refugee assistance grants to various individuals, universities, and not-for-profit organizations. Budgetary obligations are recorded when grants are awarded. Grant funds are disbursed in two ways: grantees draw funds commensurate with their immediate cash needs via the Department of Health and Human Services (HHS) Payments Management System (PMS); or grantees submit invoices. In both cases, the expense is recorded upon disbursement.

**Accounts Payable**

Accounts payable represent the amounts accrued for contracts for goods and services received but unpaid at the end of the fiscal year and unreimbursed grant expenditures. In addition to accounts payables recorded through the Department's normal business activities, domestic accounts payable also includes an estimate of unbilled payables existing at year end for which payment will be made in the subsequent period based on an average of actual disbursements over a five-year period. Beginning in FY 2005, the Department revised its method of estimating unbilled overseas accounts payable at year end, based on analysis of past payment trends applied towards current expenses.

**Annual, Sick and Other Leave**

Annual leave is accrued as it is earned, and the accrual is reduced as leave is taken. Throughout the year the balance in the accrued annual leave liability account is adjusted to reflect current pay rates. The amount of the adjustment is recorded as an expense. Current or prior year appropriations are not available to fund annual leave earned but not taken. Funding occurs in the year the leave is taken and payment is made. Sick leave and other types of non-vested leave are expensed as taken.

**Employee Benefit Plans**

**Retirement Plans:** Civil Service employees participate in either the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). Members of the Foreign Service participate in either the Foreign Service Retirement and Disability System (FSRDS) or the Foreign Service Pension System (FSPS).

Employees covered under CSRS contribute 7% of their salary; the Department contributes 7%. Employees covered under CSRS also contribute 1.45% of their salary to Medicare insurance; the Department makes a matching contribution. On January 1, 1987, FERS went into effect pursuant to Public Law 99-335. Most employees hired after December 31, 1983, are automatically covered by FERS and Social Security. Employees hired prior to January 1, 1984, were allowed to join FERS or remain in CSRS. Employees



participating in FERS contribute 0.80% of their salary, with the Department making contributions of 11.20%. FERS employees also contribute 6.20% to Social Security and 1.45% to Medicare insurance. The Department makes matching contributions to both. A primary feature of FERS is that it offers a Thrift Savings Plan (TSP) into which the Department automatically contributes 1% of pay and matches employee contributions up to an additional 4%.

Foreign Service employees hired prior to January 1, 1984, participate in FSRDS with certain exceptions. FSPS was established pursuant to Section 415 of Public Law 99-335, which became effective June 6, 1986. Foreign Service employees hired after December 31, 1983, participate in FSPS with certain exceptions. FSRDS employees contribute 7.25% of their salary; the Department contributes 7.25%. FSPS employees contribute 1.35% of their salary; the Department contributes 20.22%. Both FSRDS and FSPS employees contribute 1.45% of their salary to Medicare; the Department matches their contributions. Similar to FERS, FSPS also offers the TSP described above.

Foreign Service Nationals (FSNs) and Third Country Nationals (TCNs) at overseas posts who were hired prior to January 1, 1984, are covered under CSRS. FSNs and TCNs hired after that date are covered under a variety of local government plans in compliance with the host country's laws and regulations. In cases where the host country does not mandate plans or the plans are inadequate, employees are covered by a privately managed pension plan that conforms to the prevailing practices of comparable employers, or the FSN Defined Contribution Fund.

**Health Insurance:** Most American employees participate in the Federal Employees Health Benefits Program (FEHBP), a voluntary program that provides protection for enrollees and eligible family members in case of illness and/or accident. Under FEHBP, the Department contributes the employer's share of the premium as determined by the U.S. Office of Personnel Management (OPM).

**Life Insurance:** Unless specifically waived, employees are covered by the Federal Employees Group Life Insurance Program (FEGHIP). FEGHIP covers eligible employees for basic life insurance in amounts equivalent to an employee's annual pay, rounded up to the next thousand dollars plus \$2,000. The Department pays one-third and employees pay two-thirds of the premium. Enrollees and their family members are eligible for additional insurance coverage but the enrollee is responsible for the cost of the additional coverage.

**Other Post Employment Benefits:** The Department does not report CSRS, FERS, FEHBP or FEGHIP assets, accumulated plan benefits, or unfunded liabilities applicable to its employees; OPM reports this information. As required by SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, the Department reports the full cost of employee benefits for the programs that OPM administers. The Department recognizes an expense and imputed financing source for the annualized unfunded portion of CSRS, post-retirement health benefits, and life insurance for employees covered by these programs. The Department recognized \$116.6 and \$119.2 million in 2006 and 2005, respectively, for unfunded pension and post-retirement benefits. The additional costs are not actually owed or paid to OPM, and thus are not reported on the Balance Sheet as a liability, but instead are reported as an imputed financing source from costs absorbed from others on the Statement of Changes in Net Position.

### **Future Workers' Compensation Benefits**

The Federal Employees' Compensation Act (FECA) provides income and medical cost protection to cover Federal employees injured on the job or who have incurred a work-related occupational disease, and beneficiaries of employees whose death is attributable to job-related injury or occupational disease. The U.S. Department of Labor (DOL) administers the FECA program. DOL initially pays valid claims and bills the employing Federal agency. DOL calculates the actuarial liability for future workers' compensation benefits and reports to each agency its share of the liability.



The total actuarial liability for which the Department is responsible totaled \$62.7 million and \$60.3 million as of September 30, 2006 and September 30, 2005, respectively.

#### ***Valuation of FSN Separation Liability***

Separation payments are made to eligible FSN employees who voluntarily resign, retire, or lose their jobs due to a reduction in force, and are in countries that require a voluntary separation payment. The amount required to finance the current and future costs of FSN separation pay is determined annually.

#### ***Actuarial Present Value of Projected Plan Benefits for the Foreign Service Retirement and Disability Program***

See Note 11 "Foreign Service Retirement Actuarial Liability," on pages 289 to 290 for the Department's accounting policy for Foreign Service retirement-related benefits.

#### ***Net Position***

The Department's net position contains the following components. Amounts attributable to earmarked funds are separately disclosed. See Note 15 "Earmarked Funds" on page 294 for a description of and the Department's accounting policy for earmarked funds.

- 1. Unexpended Appropriations** — the sum of undelivered orders and unobligated balances. Undelivered orders represent the amount of obligations incurred for goods or services ordered, but not yet received. An unobligated balance is the amount available after deducting cumulative obligations from total budgetary resources. As obligations for goods or services are incurred, the available balance is reduced.
- 2. Cumulative Results of Operations** — include (1) the accumulated difference between revenues and financing sources less expenses since inception; (2) the Department's investment in capitalized assets financed by appropriation; (3) donations; and (4) unfunded liabilities, whose liquidation may require future Congressional appropriations or other budgetary resources.

#### ***Foreign Currency***

Accounting records for the Department are maintained in U.S. dollars, while a significant amount of the Department's overseas expenditures are in foreign currencies. For accounting purposes, overseas obligations and disbursements are recorded in U.S. dollars based on the rate of exchange as of the date of the transaction. Foreign currency payments are made by the Department's Disbursing Offices in Charleston, SC and Bangkok, Thailand.

## 2 ACCOUNTING CHANGES

### Standards Implemented

In 2006 and 2005, the Department implemented revised financial statement reporting requirements and new Statements of Federal Financial Accounting Standards (SFFAS). The changes did not have a material effect on the Department's financial position or results of operations. The new Standards primarily affect the manner in which the Department reports on its programs.

On July 24, 2006, OMB issued A-136, *Financial Reporting Requirements*, which provides guidance for preparing agency financial statements. It supersedes OMB Circular A-136, dated August 23, 2005, and a number of other OMB memorandum and bulletins:

The requirements contained in A-136 are effective for the preparation of financial statements for fiscal years beginning with FY 2006. Some requirements are phased in beginning with FY 2006.

As prescribed by OMB Circular A-136, the Department implements financial statement reporting requirements and new SFFASs when they become effective and if they apply to the Department's operations. The following SFFASs were implemented for FY 2006:

- ◆ SFFAS 27, *Identifying and Reporting Earmarked Funds*, dated December 28, 2004, requires separate reporting of earmarked funds on the Balance sheet and Statement of Changes in Net Position along with other disclosure requirements.
- ◆ SFFAS29, *Heritage Assets and Stewardship Land*, dated July 7, 2005, reclassifies heritage assets and stewardship land information phasing in their requirements starting in FY 2006 through FY 2009.

NEW FY 2006 OMB REPORTING REQUIREMENTS AND SFFASS	
OMB GUIDANCE	DESCRIPTION OF CHANGES
<b>A-136</b> <i>Statement of Net Cost</i>	A-136 requires separate disclosure of Intragovernmental and public costs and revenues which is moved from the face of the Consolidated Statement of Net Cost to the footnote.
<b>A-136</b> <i>Statement of Changes in Net Position</i>	A-136 changes the statement format, adding columns for earmarked funds and eliminations between earmarked funds and other reporting entity funds with disclosure in the Earmarked Funds footnote. Lines added to the statement for changes in accounting principles and corrections of errors per SFFAS 21.
<b>A-136</b> <i>Statement of Budgetary Resources</i>	A-136 changes the statement format and adds new information requirements for change in unpaid obligated balances and net outlays.
<b>A136</b> <i>Statement of Custodial Activity</i>	Exchange revenue requirements added per SFFAS 7. Requirements for accrual adjustments for nonexchange revenue clarified.
<b>A-136</b> <i>Notes to the Financial Statements</i>	<p>Disclosure required for changes in GAAP that affect the financial statements, to include explanation of concepts that are unique to Federal financial statements. Modified the provisions for restatement to comply with paragraphs 20 and 26 of SFFAS 21. Modified the Fund Balance with Treasury footnote to include non-budgetary FBWT in section B, Status of Fund Balance with Treasury (FY 2005).</p> <p>Added earmarked funds to note on investments and added note for earmarked funds per SFFAS 27, replacing the note on Dedicated Collections.</p> <p>Replaced "Intragovernmental Costs" in the note to the Statement of Net Cost with a new disclosure of intragovernmental costs and exchange revenue; removed requirement to report Gross Cost and Earned Revenue by Budget Functional Classification.</p>

NEW FY 2006 OMB REPORTING REQUIREMENTS AND SFFAS (continued)	
<b>A-136</b> <i>RSI</i>	Removed intragovernmental amounts and segment information sections. Risk assumed information removed from RSSI and included in RSI per SFFAS 5. Stewardship PP&E condition information may be moved from the RSI and reported with deferred maintenance. Deferred maintenance additional guidance added from SFFAS 6.
<b>A-136</b> <i>RSI</i>	Removed all sections on heritage asses and stewardship land to be reclassified as basic information in the RSI, except for condition information.
SFFAS	DESCRIPTION OF CHANGE
<b>SFFAS 27</b> Earmarked Funds	<p><b>Balance Sheet:</b> Separate lines added for Cumulative Results of Operations and Unexpended Appropriations for earmarked funds. As directed by SFFAS 27, the Department did not restate prior periods of the principal financial statements and related disclosures.</p> <p><b>Statement of Changes in Net Position:</b> Separate display and lines added for earmarked funds.</p> <p><b>Footnotes:</b> Information on earmarked funds added to Investments footnote (sample footnote provided in SFFAS 27). Disclosure required of all earmarked funds for which the reporting entity has program management responsibility.</p>
<b>SFFAS 29</b> <i>Heritage Assets and Stewardship Land</i>	<p><b>Balance Sheet:</b> Line added for Stewardship PP&amp;E without an asset dollar amount and with footnote disclosure.</p> <p><b>Footnotes:</b> New footnote added with requirements phased in starting with FY 2006. Disclosure explains how these assets relate to the entity's mission and a description of the entity's stewardship policies. In FY 2008, footnote will include a description of the major categories of heritage assets and physical unit information. In FY 2009, disclosure will include physical units added and withdrawn during the year and a description of methods of acquisition and withdrawal.</p> <p><b>Cost of Stewardship PP&amp;E:</b> The cost of acquiring, constructing, improving, reconstructing, or renovating heritage assets (other than multi-use heritage assets), and the cost of acquiring stewardship land and any costs to prepare stewardship land for its intended use, recognized as a cost in the Statement of Net Cost in the period in which it is incurred, reported separately on the face of the statement or in the footnotes.</p>

### Change in Accounting Estimate

The Department's Bureau of International Narcotics and Law Enforcement (INL) operates aircraft used to carry out INL's mission worldwide (see Note 1 Property and Equipment – Personal Property). As part of these activities, in 2005, the Department determined that major aircraft components – high dollar value items (replacement cost in excess of \$50,000) that are repairable (e.g., engines) and in serviceable condition (ready for use) – should be treated as general property and equipment and as such capitalized and depreciated over the life of the asset once installed on an aircraft. In 2006, the Department conducted additional analysis to determine the actual useful life of the major components once installed on the aircraft. The analysis determined that the actual useful life is less than two years, and as such does not meet the definition of general property and equipment as provided for in SFFAS No. 6, *Accounting for Property, Plant and Equipment*, paragraph 17. Nor do these major components meet the definition of inventory as provided for in SFFAS No. 3, *Accounting for Inventory and Related Property*, paragraph 17. Consequently, for 2006, the Department changed the treatment of the major components to the purchase method. The estimated historical cost for the major components was \$13.2 million at September 30, 2005, which was recorded to expense during 2006.

### 3 ASSETS

The Department's assets are classified as entity assets and non-entity assets. Entity assets are those assets that the Department has authority to use for its operations. Non-entity assets are those held by the Department but are not available for use in its operations. The vast majority of the Department's assets are entity assets. Total non-entity assets at September 30, 2006 and 2005 were \$12.7 million and \$130.1 million, respectively. These items are included in amounts reported as Cash and Other Monetary Assets (See Note 7, "Cash and Other Monetary Assets" for further information).

### 4 FUND BALANCES WITH TREASURY

Fund Balances with Treasury at September 30, 2006 and 2005, are summarized below (Dollars in Thousands)

Fund Balances	2006	2005	Status of Fund Balance	2006	2005
			Unobligated Balances		
Appropriated Funds	\$ 15,573,572	\$ 13,516,620	Available	\$ 4,803,003	\$ 3,860,903
Revolving Funds	490,436	303,818	Unavailable	484,145	410,203
Trust Funds	105,135	102,317	Obligated Balances not yet Disbursed	\$ 10,895,168	9,664,493
Special Funds	13,173	12,844	Total Unobligated and Obligated	\$ 16,182,316	\$ 13,935,599
Deposit & Receipt Accounts	(11,555)	87,943	Deposit & Receipt Accounts	(11,555)	87,943
Total	\$ 16,170,761	\$ 14,023,542	Total	\$ 16,170,761	\$ 14,023,542

## 5 INVESTMENTS

### Summary of Investments

Investments at September 30, 2006 and 2005, are summarized below (Dollar in Thousands). All investments are classified as Intragovernmental Securities.

At September 30, 2006:	Par	Unamortized Premium (Discount)	Interest Receivable	Investments (Net)	Market Value	Maturity Dates	Interest Rates Range
Non-Marketable, Par Value:							
Special Issue Securities	\$ 13,875,717	\$ —	\$ 191,762	\$ 14,067,479	\$ 13,875,717	2007-2021	3.50%-7.375%
Subtotal	\$ 13,875,717	\$ —	\$ 191,762	\$ 14,067,479	\$ 13,875,717		
Non-Marketable, Market Based:							
Israeli-Arab Scholarship, Notes	4,723	11	80	4,814	4,732	2006-2008	3.125%-6.625%
Eisenhower Exchange Fellowship, Notes	7,521	(8)	45	7,558	7,505	2007-2014	3.25%-6.25%
Middle Eastern–Western Dialogue, Note	17,096	556	294	17,946	17,406	2006-2010	2.25%-6.625%
Gift Funds, Bills	4,005	(37)	—	3,968	3,970	2006	2.41%
Subtotal	\$ 33,345	\$ 522	\$ 419	\$ 34,286	\$ 33,613		
Total Investments	\$ 13,909,062	\$ 522	\$ 192,181	\$ 14,101,765	\$ 13,909,330		

At September 30, 2005:	Par	Unamortized Premium (Discount)	Interest Receivable	Investments (Net)	Market Value	Maturity Dates	Interest Rates Range
Non-Marketable, Par Value:							
Special Issue Securities	\$ 13,359,486	\$ —	\$ 184,463	\$ 13,543,949	\$ 13,359,486	2006-2019	3.50%-8.125%
Subtotal	\$ 13,359,486	\$ —	\$ 184,463	\$ 13,543,949	\$ 13,359,486		
Non-Marketable, Market Based:							
Israeli-Arab Scholarship, Notes	4,974	21	72	5,067	5,034	2006-2007	2.25%-7.00%
Eisenhower Exchange Fellowship, Notes	7,516	11	46	7,573	7,650	2006-2014	3.25%-6.25%
Middle Eastern–Western Dialogue, Note	12,367	729	186	13,282	12,902	2006-2010	2.375%-6.50%
Gift Funds, Bills	4,010	(24)	—	3,986	4,020	2006	1.54%-1.57%
Subtotal	\$ 28,867	\$ 737	\$ 304	\$ 29,908	\$ 29,606		
Total Investments	\$ 13,388,353	\$ 737	\$ 184,767	\$ 13,573,857	\$ 13,389,092		

The Department's activities that have the authority to invest cash resources are earmarked funds (see Note 15 "Earmarked Funds"). The Federal Government does not set aside assets to pay future benefits or other expenditures associated with earmarked funds. The cash receipts collected from the public for an earmarked fund are deposited in the U.S. Treasury, which uses the cash for general Government purposes. Treasury securities are issued to the Department as evidence of its receipts. Treasury securities are an asset to the Department and a liability to the U.S. Treasury. Because the Department and the U.S. Treasury are both parts of the Government,



these assets and liabilities offset each other from the standpoint of the Government as a whole. For this reason, they do not represent an asset or a liability in the U.S. Government-wide financial statements.

Treasury securities provide the (component entity) with authority to draw upon the U.S. Treasury to make future benefit payments or other expenditures. When the Department requires redemption of these securities to make expenditures, the Government finances those expenditures out of accumulated cash balances, by raising taxes or other receipts, by borrowing from the public or repaying less debt, or by curtailing other expenditures. This is the same way that the Government finances all other expenditures.

Although funds in the Chancery Development Trust Account and the Bosnia Federation Defense Fund are invested, because they are considered non-entity assets the investments for these funds are not shown in this section, but are described in Note 7, "Cash and Other Monetary Assets"

## 6 ACCOUNTS AND LOANS RECEIVABLE, NET

The Department's Accounts Receivable and Loans Receivable at September 30, 2006 and 2005, are summarized here (Dollars in Thousands). All are entity receivables.

	2006			2005		
	Entity Receivables	Allowance for Uncollectible	Net Receivables	Entity Receivables	Allowance for Uncollectible	Net Receivables
Intragovernmental Accounts Receivable	\$ 359,998	\$ (15,960)	\$ 344,038	\$ 627,529	\$ (28,338)	\$ 599,191
Non-Intragovernmental Accounts and Loans Receivable	42,726	(8,407)	34,319	79,154	(8,797)	70,357
Total Receivables	\$ 402,724	\$ (24,367)	\$ 378,357	\$ 706,683	\$ (37,135)	\$ 669,548

Included in Non-Intragovernmental Accounts and Loans Receivable are approximately (\$123) thousand and \$417 thousand, in 2006 and 2005, respectively, of Repatriation Loans administered by the Department. Repatriation Loans enable destitute American citizens overseas to return to the United States. Repatriation loans made prior to 1992 are reported net of an allowance for uncollectible loans based upon historical experience. The Federal Credit Reform Act of 1990 (the Act), as amended, governs Repatriation loan obligations made after 1991, and the resulting direct loans. The Act requires that the present value of all direct costs (i.e., interest rate differentials, estimated delinquencies and defaults) associated with a loan be recognized and funded completely in the year the loan is disbursed. This value is termed the "subsidy cost" for the year, and is expressed as a percentage of the total face amount of loans disbursed that year. Funding for subsidy costs for loans made after 1991 establishes the subsidy allowance against which future collections and future loan write-offs are netted. In FY 2006, the subsidy was greater than the loans outstanding. Per the provisions of the Act, the Department borrows from Treasury the difference between the face value of loans disbursed and their calculated subsidy costs. The administrative costs associated with loan administration are separately budgeted and funded.

## 7 CASH AND OTHER MONETARY ASSETS

The Cash and Other Monetary Assets at September 30, 2006 and 2005, are summarized below (Dollars in Thousands). There are no restrictions on entity cash. Non-Entity cash is restricted as discussed below.

	2006			2005		
	Entity Assets	Non-Entity Assets	Total	Entity Assets	Non-Entity Assets	Total
Hurricane Katrina Relief Efforts	\$ —	\$ —	\$ —	\$ —	\$ 116,418	\$ 116,418
Chancery Development						
Trust Account:						
Treasury Bills, at par	—	12,905	12,905	—	13,826	13,826
Unamortized Discount	—	(205)	(205)	—	(163)	(163)
Cash-Imprest and Other Funds	35,966	—	35,966	29,121	—	29,121
Total	\$ 35,966	\$ 12,700	\$ 48,666	\$ 29,121	\$ 130,081	\$ 159,202

Lease fees collected from foreign governments for the International Chancery Center are deposited into an escrow account called the Chancery Development Trust Account. The funds are unavailable to the Department at time of deposit, and do not constitute expendable resources until funds are necessary for additional work on the Center project. The Chancery Development Trust account invests in six-month marketable Treasury bills issued at discount and redeemable for par at maturity. A corresponding liability for these amounts is reflected as Funds Held in Trust and Deposit Accounts.

In response to the widespread devastation caused by Hurricane Katrina, the United States received a generous outpouring of assistance from foreign governments and other foreign entities. The Department facilitated the collection of donations of monetary assistance, which were deposited to the Department's custodial Treasury deposit account pending transfer to entities assisting in the recovery efforts. Pledged monetary donations are not reflected in the Department's financial statements due to the uncertainty of collection. The Department did not receive any in-kind contributions relating to Hurricane Katrina. A corresponding liability for the amount of monetary assistance collected by the Department but not transferred to other entities as of September 30, 2005 is reflected as Funds Held in Trust and Deposit Accounts.

## 8 PROPERTY AND EQUIPMENT, NET

Property and equipment balances at September 30, 2006 and 2005, are shown in the following table (Dollars in Thousands):

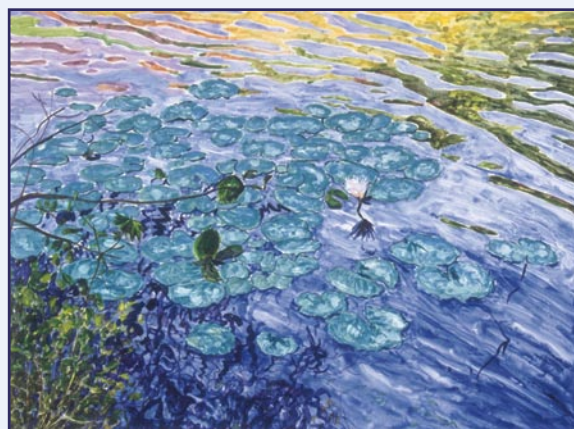
Major Classes	2006			2005 (Restated)		
	Cost	Accumulated Depreciation	Net Value	Cost	Accumulated Depreciation	Net Value
Real Property:						
Overseas —						
Land and Land Improvements	\$ 2,013,634	\$ (1,650)	\$ 2,011,984	\$ 1,986,970	\$ (1,119)	\$ 1,985,851
Buildings and Structures	6,849,444	(3,080,559)	3,768,885	5,944,276	(2,864,663)	3,079,613
Construction-in-Progress	1,940,647	—	1,940,647	1,339,924	—	1,339,924
Assets Under Capital Lease	76,503	(29,704)	46,799	55,707	(27,257)	28,450
Leasehold Improvements	306,367	(88,323)	218,044	213,680	(85,644)	128,036
Domestic —						
Structures, Facilities and Leaseholds	586,352	(232,387)	353,965	583,944	(218,316)	365,628
Construction-in-Progress	21,007	—	21,007	21,006	—	21,006
Land and Land Improvements	80,782	(5,086)	75,696	80,733	(4,774)	75,959
Subtotal — Real Property	\$ 11,874,736	\$ (3,437,709)	\$ 8,437,027	\$ 10,226,240	\$ (3,201,773)	\$ 7,024,467
Personal Property:						
Aircraft	\$ 624,452	\$ (297,018)	\$ 327,434	\$ 601,381	\$ (260,365)	\$ 341,016
Vehicles	334,095	(192,692)	141,403	317,652	(169,120)	148,532
Communication Equipment	52,158	(42,959)	9,199	59,981	(38,289)	21,692
ADP Equipment	59,585	(42,321)	17,264	56,177	(45,319)	10,858
Reproduction Equipment	13,218	(10,005)	3,213	12,933	(10,434)	2,499
Security	92,770	(52,037)	40,733	87,138	(44,178)	42,960
Software	199,558	(123,402)	76,156	194,666	(86,243)	108,423
Software-in-Development	121,468	—	121,468	99,539	—	99,539
Other Equipment	212,187	(210,167)	2,020	152,622	(89,996)	62,626
Subtotal — Personal Property	\$ 1,709,491	\$ (970,601)	\$ 738,890	\$ 1,582,089	\$ (743,944)	\$ 838,145
Total	\$ 13,584,227	\$ (4,408,310)	\$ 9,175,917	\$ 11,808,329	\$ (3,945,717)	\$ 7,862,612

**Stewardship PP&E**

The Department has collections of art, furnishings and real property (Culturally Significant Property) that are held for public exhibition, education, and official entertainment for visiting Chiefs of State, Heads of Government, Foreign Ministers, and other distinguished foreign and American guests. As the lead institution in the conduct of American diplomacy, this property is used to promote national pride and the distinct cultural diversity of American artists and to recognize the historical, architectural and cultural significance of the Department's overseas operations.

The Department has six separate collections of art and furnishings: the Diplomatic Reception Rooms, the Art Bank, Art in Embassies, Curatorial Services Program, the Library Rare and Special Book Collection, and the Secretary of State's Register of Culturally Significant Property. The collections, described in the Required Supplementary Information (RSI) section of this report, consist of items that were donated, purchased using donated or appropriated funds, or are on loan from individuals, organizations, or museums. The Department provides protection and preservation services for these collections.

The stewardship PP&E items that the Department owns are considered heritage assets (see "Required Supplementary Information — Heritage Assets"). In accordance with SFFAS No. 29, *Heritage Assets and Stewardship Land*, no value is assigned to these assets in the Consolidated Balance Sheet. Purchases of items for collections are recorded as an expense in the year of purchase. Proceeds from disposals are recognized as revenue in the year of sale and are designated for future collection acquisitions.



Judith Miller  
*Water Lillies/Greenbrook Sanctuary #1*

## 9 OTHER ASSETS

The Department's other assets at September 30, 2006 and 2005, are summarized below (Dollars in Thousands).

	2006	2005
Salary Advances to Employees	\$ 9,536	\$ 8,140
Travel Advances to Employees	12,566	37,472
Other Advances and Prepayments	157,395	14,262
Inventory Held for Current Sale	7,489	6,358
Total Other Assets	\$ 186,986	\$ 66,232

## 10 LIABILITIES

The Environmental Liabilities on the Balance Sheet at September 30, 2006 and 2005 were \$392.3 million, and represent the estimated cost of upgrades, constructions, and projected operation and maintenance costs of wastewater treatment plants owned and operated by IBWC. Other Liabilities on the Balance Sheet at September 30, 2006 and 2005 were \$876.4 million and 810.5 million, respectively, and consist of the following.

	2006	2005
Accrued Annual Leave	237,949	224,401
Funds Held in Trust and Deposit Accounts	12,700	130,081
Accrued Salaries Payable	112,856	108,639
Federal Employees Compensation Act Benefits	62,669	60,288
Pension Benefits Payable	48,164	45,914
Capital Lease Liability	59,466	39,497
Deferred Revenues	288,061	23,833
Other	54,561	177,821
<b>Total Other Liabilities</b>	<b>\$ 876,426</b>	<b>\$ 810,474</b>

The Department's liabilities are classified as covered by budgetary resources or not covered by budgetary resources. Liabilities not covered by budgetary resources result from the receipt of goods and services, or occurrence of eligible events in the current or prior periods, for which revenue or other funds to pay the liabilities have not been made available through appropriations or current earnings of the Department. The liabilities in this category at September 30, 2006 and 2005, are summarized below (Dollars in Thousands).

	2006	2005
Liability to International Organizations	1,155,344	1,178,130
Environmental Liabilities	392,300	392,300
Foreign Service Retirement Actuarial Liability	193,430	(72,528)
Other Liabilities:		
Accrued Annual Leave	237,949	224,401
Funds Held in Trust and Deposit Accounts	12,700	130,081
Federal Employees Compensation Act Benefits	62,669	60,288
Capital Lease Liability	59,466	39,497
Intragovernmental Other	14,541	16,813
<b>Total Liabilities Not Covered By Budgetary Resources</b>	<b>\$ 2,128,399</b>	<b>\$ 1,968,982</b>
<b>Total Liabilities Covered By Budgetary Resources</b>	<b>\$ 15,764,648</b>	<b>\$ 15,111,016</b>
<b>Total Liabilities</b>	<b>\$ 17,893,047</b>	<b>\$ 17,079,998</b>

## 11 FOREIGN SERVICE RETIREMENT ACTUARIAL LIABILITY

The Foreign Service Retirement and Disability Fund finances the operations of the FSRDS and the FSPS. The FSRDS and the FSPS are defined-benefit single-employer plans. FSRDS was originally established in 1924; FSPS in 1986. The FSRDS is a single-benefit retirement plan. Retirees receive a monthly annuity from FSRDS for the rest of their lives. FSPS provides benefits from three sources: a basic benefit (annuity) from FSPS, Social Security, and the Thrift Savings Plan.

The Department's financial statements present the Pension Actuarial Liability of the Foreign Service Retirement and Disability Program (the "Plan") as the actuarial present value of projected plan benefits, as required by the SFFAS No. 5, *Accounting for Liabilities of the Federal Government*. The Pension Actuarial Liability represents the future periodic payments provided for current employee and retired Plan participants, less the future employee and employing Federal agency contributions, stated in current dollars.

Future periodic payments include benefits expected to be paid to (1) retired or terminated employees or their beneficiaries; (2) beneficiaries of employees who have died; and (3) present employees or their beneficiaries, including refunds of employee contributions as specified by Plan provisions. Total projected service is used to determine eligibility for retirement benefits. The value of voluntary, involuntary, and deferred retirement benefits is based on projected service and assumed salary increases. The value of benefits for disabled employees or survivors of employees is determined by multiplying the benefit the employee or survivor would receive on the date of disability or death, by a ratio of service at the valuation date to projected service at the time of disability or death.

The Pension Actuarial Liability is calculated by applying actuarial assumptions to adjust the projected plan benefits to reflect the discounted time value of money and the probability of payment (by means of decrements such as death, disability, withdrawal or retirement) between the valuation date and the expected date of payment.

The economic assumptions used for the valuation (other than the assumed merit salary increases) match the economic assumptions approved by the Board of Actuaries of the Civil Service Retirement and Disability Fund for use in performing the dynamic actuarial valuations of CSRS and FERS. All the other assumptions used for the valuation are based upon the actual past experience of the covered lives under the two retirement systems. The Plan uses the aggregate entry age normal actuarial cost method, whereby the present value of projected benefits for each employee is allocated on a level basis (such as a constant percentage of salary) over the employee's service between entry age and assumed exit age. The portion of the present value allocated to each year is referred to as the normal cost.

The Board of Actuaries did change two economic assumptions since the last valuation. First, the general salary increase was changed from 4.00% to 4.25%, and second, the inflation rate was changed from 3.25% to 3.50%. Based on the new economic assumptions, the plan actuary revised the normal cost percentages. The table below presents the normal costs for FY 2006 and FY 2005.

	FY 2006	FY 2005
Normal Cost:		
FSRDS	30.35%	28.86%
FSPS	25.38%	24.24%



Actuarial assumptions are based on the presumption that the Plan will continue. If the Plan terminates, different actuarial assumptions and other factors might be applicable for determining the actuarial present value of accumulated plan benefits.

The following table presents the calculation of the combined FSRDS and FSPS Pension Actuarial Liability and the assumptions used in computing it for the years ended September 30, 2006 and 2005 (Dollars in Thousands).

<b>For the Year Ended September 30,</b>	<b>2006</b>	<b>2005</b>
Pension Actuarial Liability, Beginning of Year	\$ 13,429,300	\$ 13,317,900
Add Pension Expense:		
Normal Cost	274,800	237,600
Interest on Pension Liability	826,000	818,700
Prior Service Costs	—	—
Actuarial Losses/(Gains)	386,100	(267,800)
Total Pension Expense	1,486,900	788,500
Less Payments to Beneficiaries (annuities and refunds)	(700,900)	(677,100)
Pension Actuarial Liability, End of Year	14,215,300	13,429,300
Less: Net Assets Available for Benefits	(14,021,870)	(13,501,828)
Actuarial Unfunded Pension Liability for Projected Plan Benefits	\$ 193,430	\$ (72,528)
Actuarial Assumptions:		
Rate of Return on Investments	6.25%	6.25%
Rate of Inflation	3.50%	3.25%
Salary Increase	4.25%	4.00%

Net Assets Available for Benefits at September 30, 2006 and 2005, consist of the following (Dollars in Thousands):

	<b>2006</b>	<b>2005</b>
Fund Balances with Treasury	\$ 2,070	\$ 78
Receivables	201,314	198,701
Investments in USG Securities	13,875,717	13,359,486
Total Assets	14,079,101	13,558,265
Less: FSRDF Liabilities	(57,231)	(56,437)
Net Assets Available for Benefits	\$ 14,021,870	\$ 13,501,828

## 12 LIABILITIES TO INTERNATIONAL ORGANIZATIONS

The Department reports an unfunded liability for the accumulated arrears assessed by the United Nations (UN), its affiliated agencies, and other international organizations in the amount of \$60.0 million for both 2006 and 2005 for regular budget assessments and international peacekeeping. These financial commitments mature into obligations (as that term is used in domestic law) only when funds are authorized and appropriated by Congress.

The financial statements also report an unfunded liability of \$ 1.095 billion and \$1.118 billion at September 30, 2006 and 2005, respectively, for the current year 2006 and 2005 unfunded or restricted annual assessments from the United Nations, its affiliated agencies and several other international organizations, as well as for peacekeeping. It has been the Department's policy to pay annual assessments for the UN and certain international organizations out of the following fiscal year's appropriation, usually in the last quarter of the calendar year (i.e., the 2006 calendar year assessment is paid from the Department's 2007 appropriation). The Liability to International Organizations at September 30, 2006 and 2005, is summarized below (Dollars in Thousands).

	2006	2005
Accumulated Arrears	\$ 60,029	\$ 60,029
Unfunded Annual Assessments	1,095,315	1,118,101
Liability to International Organizations	\$ 1,155,344	\$ 1,178,130

## 13 LEASES

The Department is committed to over 12,000 leases, which cover office and functional properties, and residential units at diplomatic missions overseas. The majority of these leases are short-term operating leases. In most cases, management expects that the leases will be renewed or replaced by other leases. Personnel from other U.S. Government agencies occupy some of the leased facilities (both residential and non-residential). These agencies reimburse the Department for the use of the properties. Reimbursements are received for approximately \$61.0 million of the lease costs.

### Capital Leases

The Department has various long-term leases (more than 10 years) for overseas real property that meet the criteria as a capital lease in accordance with SFFAS No. 6, *Accounting for Property, Plant, and Equipment*. Assets that meet the definition of a capital lease and their related lease liability, are initially recorded at the present value of the future minimum lease payments or fair market value, whichever is less. In general, capital assets are depreciated over the estimated remaining life of the asset, and the related liability is amortized over the term of the lease, which can result in a different value in the asset versus the liability.

Following is a summary of Net Assets Under Capital Leases and future minimum lease payments as of September 30 (Dollars in Thousands).

	2006	2005
Net Assets Under Capital Leases:		
Land and Buildings	\$ 76,503	\$ 55,707
Accumulated Depreciation	(29,704)	(27,257)
Net Assets under Capital Leases	\$ 46,799	\$ 28,450

#### Future Minimum Lease Payments

2006		2005	
Fiscal Year	Lease Payments	Fiscal Year	Lease Payments
2007	\$ 3,636	2006	\$ 2,616
2008	3,685	2007	2,670
2009	4,065	2008	2,719
2010	3,738	2009	3,099
2011	4,218	2010	2,772
2012 and thereafter	147,426	2011 and thereafter	99,377
Total Minimum Lease Payments	\$ 166,768		\$ 113,253
Less: Amount Representing Interest	(107,302)		(73,756)
Obligations under Capital Leases	\$ 59,466		\$ 39,497

#### Operating Leases

The Department leases real property in overseas locations under operating leases. These leases expire in various years. Minimum future rental payments under operating leases having remaining terms in excess of one year as of September 30, 2006 for each of the next 5 years and in aggregate are as follows (Dollars in Thousands).

Year Ended September 30	Operating Lease Amounts
2007	\$ 417,373
2008	298,818
2009	191,252
2010	122,813
2011	81,392
2012 and thereafter	213,398
Total Minimum Future Lease Payments	\$ 1,325,046

## 14 COMMITMENTS AND CONTINGENCIES

### Commitments

In addition to the future lease commitments discussed in Note 13, "Leases," the Department is committed under obligations for goods and services which have been ordered but not yet received (undelivered orders — see Note 15, "Unexpended Appropriations" and Note 17, "Statement of Budgetary Resources") at fiscal year end. In FY 2005 appropriations, the Department of State received \$6 million to subsidize the cost of a direct loan of up to \$1.2 billion to the United Nations to cover the cost of renovating its headquarters in New York City. As of the date of this Report, the loan agreement had not been ratified.


### Contingencies

**Rewards for Justice Program.** The Department operates rewards programs for information critical to combating international terrorism, narcotics trafficking, and war crimes. The Terrorism Information Rewards Program offers rewards up to \$25 million for information leading to: the arrest or conviction in any country of persons committing (or conspiring or attempting to commit, or aiding or abetting the commission of) acts of international terrorism against United States persons or property; the prevention, frustration or favorable resolution of such acts; the identification or location of key leaders of a terrorist organization; or the disruption of financial mechanisms of a foreign terrorist organization. The Narcotics Information Rewards Program offers rewards up to \$5 million for information leading to: the arrest or conviction in any country of persons committing (or conspiring or attempting to commit, or aiding and abetting the commission of) major foreign violations of U.S. narcotics laws or the killing or kidnapping of U.S. narcotics law enforcement officers or their family members; or the prevention, frustration or favorable resolution of such criminal acts. The War Crimes Information Rewards Program currently offers rewards up to \$5 million for information leading to the arrest, transfer, or conviction of persons indicted by the International Criminal Tribunal for the Former Yugoslavia or the International Criminal Tribunal for Rwanda for serious violations of international humanitarian law, or their arrest or conviction in any country for such violations. Authority exists to create a similar war crimes program for information related to indictees of the Special Court of Sierra Leone.

The Department is a party in various administrative proceedings, legal actions, environmental suits, and claims brought by and against it. Some of the actions are not related directly to Department programs but the Department is involved because of its status as the U.S. Government's foreign policy agency. In the opinion of management and legal counsel, the ultimate resolution of these proceedings, actions, and claims will not materially affect the financial position or results of operations of the Department.

**Claims Filed in Response to Embassy Bombings:** The families of eleven of the twelve Americans killed in the bombing filed administrative tort claims with the Department alleging that Department negligence led to the death of their family members in Nairobi. These claims, including those by the estates of the deceased, are for a total of \$117 million. Recent Supreme Court jurisprudence has ruled out liability under the Act for injuries or deaths suffered abroad. We are reviewing the claims under the Secretary's discretion as authorized by the Basic Authorities Act and in conjunction with proposed litigation for compensation to victims of terrorism. Any settlements made under the Secretary's discretionary authority in excess of \$2,500 would be funded and paid from the Judgment Fund maintained by the Treasury.

**SAVING LIVES**  
is the best reason



**...to stop a terrorist!**

Terrorist attacks randomly kill innocent women and children of every religion, race and nationality. You can help stop this tragic loss of life by providing information that prevents a terrorist act. You can save lives, protect families, and preserve the peace.

To prevent future acts of terrorism, the U.S. Government is offering a reward for information leading to the arrest of anyone attempting an act of terrorism against U.S. persons or property. The reward may also be paid to individuals providing information about prior terrorist acts. Those providing information may be eligible for a reward of up to \$5 million and relocation with their families. Your response will be kept strictly confidential. This reward can not bring back innocent lives lost, but it can bring their murderers to justice.


If you have information, please contact the nearest U.S. embassy or consulate or write:

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Email: mail@rewardsforjustice.net



**The Family You Save May Be Your Own**

**North American Free Trade Agreement (NAFTA) Arbitrations:** The United States is currently defending itself against more than one hundred claims submitted to arbitration and one claim not yet submitted – facing approximately \$1.4 billion in potential liability – under chapter Eleven (investment) of the North American Free trade Agreement (NAFTA). The United States has successfully defended itself against four claims submitted to arbitration under Chapter Eleven of the NAFTA. In no case is the Department a named respondent in these arbitrations. Any adverse award in any of these cases would be paid out of the Judgment Fund.

**Fluor Intercontinental Inc. (Astana Embassy Project).** The claimant has asserted three claims, totaling \$36,032,537, for work on one contract in building the new embassy compound in Astana, Kazakhstan related to the installation of piles for the foundation, the perimeter wall, and the impact of the alleged delay in the construction of the infrastructure. The Contracting Officer has denied the claims, and the Department awaits appeal of the denial. Claimant is unlikely to be able to provide its claims, which appear to be very inflated. It is not possible at this time to accurately access within a predictable range the estimated amount of losses which would be probable or reasonably possible.

**Fluor Intercontinental Inc. (Kingston Embassy Project).** Claimant is seeking return of \$12.2 million in two separate claims for alleged Government delay in the construction of the new embassy compound in Kingston, Jamaica. The first claim for \$3.7 million has been evaluated to be without merit and has been denied by the Contracting Officer. The Department awaits appeal of the denial. The second claim for \$8.5 million is before the Contracting Officer for review – the Contracting Officer's Technical Representative has recommended denial of the claim. It is not possible at this time to accurately access within a predictable range the estimated amount of losses which would be probable or reasonably possible.

**Fluor Intercontinental Inc. (Frankfurt Project).** Fluor Intercontinental has asserted numerous discrete claims pertaining to renovation of Air Force Hospital in Frankfurt for use as the Consulate General, plus large delay and constructive acceleration claims said to arise from impact of the discrete claims on the construction schedule. The total amount of the global claim is anticipated to be approximately \$20 million. The certified global claim has not yet been submitted. The Department will review the certified claim in an effort to settle all or part of the dispute prior to litigation. After Department review, mediation will occur before the General Service Board of Contract Appeals Chairman Stephen Daniels. There are numerous weaknesses in most of the discrete claims and the global claim is not yet available for evaluation. It is not possible at this time to accurately assess, within a predictable range, the estimated amount of losses which would be probable or reasonably possible.

Certain legal matters to which the Department is a party are administered and, in some instances, litigated and paid by other U.S. Government agencies. Generally, amounts to be paid under any decision, settlement, or award pertaining to these legal matters are funded from the Judgment Fund. None of the amounts paid under the Judgment Fund on behalf of the Department in 2006 and 2005 had a material effect on the financial position or results of operations of the Department.

## 15 EARMARKED FUNDS

**E**armarked funds are financed by specifically identified revenues, often supplemented by other financing sources, which remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities, benefits or purposes, and accounted for separately from the Government's general revenues. See Note 5 "Investments" for further information on investments in U.S. Treasury securities for earmarked funds. This note supercedes the "Dedicated Collections" note in previously issued financial statements. There are no intradepartmental transactions between the various earmarked funds.

The Department administers thirteen earmarked funds as listed below. A brief description of the individually reported earmark funds and their purpose follows.

Treasury Fund Symbol	Description	Statute
19X5497	Foreign Service National Defined Contribution Fund	22 USC 3968(a)(1)
19X8166	American Studies Endowment Fund	108 Stat 425
19X8167	Trust Funds	22 USC 1479
19X8186	Foreign Service Retirement and Disability Fund	22 USC 4042-4065
19X8271	Israeli Arab Scholarship Programs	105 Stat. 696, 697
19X8272	Eastern Europe Student Exchange Endowment Fund	105 Stat. 699
19X8340	Foreign Service National Liability Trust Fund	105 Stat. 672
19X8341	Foreign Service National Liability Trust Fund	105 Stat. 672
19X8812	Gifts and Bequests, National Commission on Educational, Scientific, and Cultural Cooperation	22 USC 287q
19X8813	Center for Middle Eastern-Western Dialogue Trust Fund	118 Stat. 84
19X8821	Unconditional Gift Fund	22 USC 809, 1046
19X8822	Conditional Gift Fund	22 809, 1046
95X8276	Eisenhower Exchange Fellowship Program Trust Fund	PL 101-454

#### ***Foreign Service National Defined Contributions Retirement Fund (FSNDCF) (19X5497)***

The Foreign Service National Defined Contributions Retirement Fund is a retirement savings program designed to provide benefits upon separation to locally employed staff under local compensation plans at overseas U.S. diplomatic or consular missions or establishments. Contributions are made to the FSNDCF by the Department's appropriations from which the benefits are paid.

#### ***Foreign Service Retirement and Disability Fund (19X8186)***

The Foreign Service Retirement and Disability Fund (FSRDF) was established in 1924 to provide pensions to retired and disabled members of the Foreign Service. The FSRDF's revenues consist of contributions from active participants and their U.S. Government agency employers; appropriations; and interest on investments. Monthly annuity payments are made to eligible retired employees or their survivors. Separated employees without title to an annuity may take a refund of their contributions. P.L. 96-465 limits the amount of administrative expense that can be charged to the fund to \$5,000. The total cost for administering FSRDF was \$4.3 million in both 2006 and 2005, respectively. Cash is invested in U.S. Treasury securities until it is needed for disbursement. The Department also issues separate annual financial statements for the FSRDF.

#### ***Foreign Service National Separation Liability Trust Funds (FSNSLTF) (19X8340 and 19X8341)***

FSNSLTF funds separation liabilities to foreign service national (FSNs) and personal service contractor (PSCs) employees who voluntarily resign, retire, or lose their jobs due to a reduction in force. The liability is applicable only in those countries that, due to local law, require a lump-sum voluntary separation payment based on years of service. The FSNSLTF was authorized in 1991 and initially capitalized with a transfer from the Department. Contributions are made to the FSNSLTF by the Department's appropriations, from which the FSNs and PSCs are paid. Once the liability to the separating FSN or PSC is computed in accordance with the local compensation plan, the actual disbursement is made from the FSNSLTF.

#### ***Conditional and Unconditional Gift Funds (19X8821 and 19X8822)***

The Department maintains two Trust Funds for receiving and disbursing donations. It is authorized to accept gifts from private organizations and individuals in the form of cash, gifts-in-kind, and securities. Gifts are classified as Restricted or Unrestricted Gifts.



Restricted Gifts must be used in the manner specified by the donor. Unrestricted Gifts can be used for any expense normally covered by an appropriation, such as representational purposes or embassy refurbishment.

(Dollars in Thousands)	FSRDF	FSNSLTF	FSNDCF	GIFT	Total - Other Earmarked	Total Earmarked Funds
<b>Balance Sheet As of September 30, 2006:</b>						
<b>Assets:</b>						
Fund Balances with Treasury	\$ 2,070	\$ 87,768	\$ 49	\$ 11,925	\$ 3,373	\$ 105,185
Investments	13,875,717	—	—	3,968	29,899	13,909,584
Taxes and Interest Receivable	191,762	—	—	—	419	192,181
Other Assets	9,552	—	34,564	1,695	4	45,815
<b>Total Assets</b>	<b>\$ 14,079,101</b>	<b>\$ 87,768</b>	<b>\$ 34,613</b>	<b>\$ 17,588</b>	<b>\$ 33,695</b>	<b>\$ 14,252,765</b>
Actuarial Liability	\$ 14,215,300	\$ —	\$ —	\$ —	\$ —	\$ 14,215,300
Other Liabilities	57,231	—	49	1	8	57,289
<b>Total Liabilities:</b>	<b>\$ 14,272,531</b>	<b>\$ —</b>	<b>\$ 49</b>	<b>\$ 1</b>	<b>\$ 8</b>	<b>\$ 14,272,589</b>
Unexpended Appropriations	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Cumulative Results of Operations	(193,430)	87,768	34,564	17,587	33,687	(19,824)
<b>Total Liabilities and Net Position</b>	<b>\$ 14,079,101</b>	<b>\$ 87,768</b>	<b>\$ 34,613</b>	<b>\$ 17,588</b>	<b>\$ 33,695</b>	<b>\$ 14,252,765</b>
<b>Statement of Net Cost for the Period Ended September 30</b>						
Gross Program Costs	\$ —	\$ 12,491	\$ 1,716	\$ 4,155	\$ 878	\$ 19,240
Less Earned Revenues	1,220,904	10,464	8,539	—	—	1,239,907
<b>Net Program Costs</b>	<b>(1,220,904)</b>	<b>2,027</b>	<b>(6,823)</b>	<b>4,155</b>	<b>878</b>	<b>(1,220,667)</b>
Costs Not Attributable to Program Costs	1,486,862	—	—	—	—	1,486,862
Less Earned Revenues Not Attributable to Program Costs	—	—	—	—	—	—
<b>Net Cost of Operations</b>	<b>\$ 265,958</b>	<b>\$ 2,027</b>	<b>\$ (6,823)</b>	<b>\$ 4,155</b>	<b>\$ 878</b>	<b>\$ 266,195</b>
<b>Statement of Changes in Net Position for the Period Ended September 30</b>						
Net Position Beginning of Period	\$ 72,528	\$ 89,795	\$ 27,741	\$ 13,758	\$ 28,440	\$ 232,262
Non-Exchange Revenue	\$ —	\$ —	\$ —	\$ 7,984	\$ 1,189	\$ 9,173
Other Financing Sources	—	—	—	—	4,936	4,936
Net Cost of Operations	(265,958)	(2,027)	6,823	(4,155)	(878)	(266,195)
Taxes and Other Nonexchange Revenue	—	—	—	—	—	—
<b>Change in Net Position</b>	<b>\$ (265,958)</b>	<b>\$ (2,027)</b>	<b>\$ 6,823</b>	<b>\$ 3,829</b>	<b>\$ 5,247</b>	<b>\$ (252,086)</b>
<b>Net Position End of Period</b>	<b>\$ (193,430)</b>	<b>\$ 87,768</b>	<b>\$ 34,564</b>	<b>\$ 17,587</b>	<b>\$ 33,687</b>	<b>\$ (19,824)</b>

## 16 STATEMENT OF NET COST

The Consolidated Statement of Net Cost reports the Department's gross and net cost for its strategic objectives and strategic goals. The net cost of operations is the gross (i.e., total) cost incurred by the Department, less any exchange (i.e., earned) revenue.

The Consolidating Schedule of Net Cost categorizes costs and revenues by strategic goal and responsibility segment. A responsibility segment is the component that carries out a mission or major line of activity, and whose managers report directly to top management. For the Department, a Bureau (e.g., Bureau of African Affairs) is considered a responsibility segment. For presentation purposes, Bureaus have been summarized and reported at the Under Secretary level (e.g., Under Secretary for Political Affairs).

The presentation of program results by strategic objectives and strategic goals is based on the Department's current Strategic Plan established pursuant to the Government Performance and Results Act of 1993. The Department's strategic goals and objectives are defined in Management's Discussion and Analysis section of this report.

The Management and Organizational Excellence strategic goal relates to the Department's responsibilities for managing infrastructure, information, and human resources. The ability of the Department to advance national and foreign policy interests depends on the quality of these items — the two largest and most visible of which are Diplomatic Security and Overseas Buildings Operations.

## DEPARTMENT OF STATE CONSOLIDATING SCHEDULE OF NET COST

For the year ended September 30, 2006

(Dollars in Thousands)

(Dollars in Thousands)	Under Secretary for								
	Arms Control, Int'l Security	Economic, Business and Agriculture	Global Affairs	Political Affairs	Public Diplomacy and Public Affairs	Management - Consular Affairs			
STRATEGIC GOAL							Eliminations		Total
<b>Regional Stability</b>									
Total Cost	\$ 168,968	\$ 10,145	\$ 40,624	\$ 1,115,805	\$ —	\$ (25)	\$ (50,339)		\$ 1,285,178
Earned Revenue	(23,326)	(1,619)	(6,306)	(130,997)	—	(2)	50,339		(111,911)
Net Program Costs	145,642	8,526	34,318	984,808	—	(27)	—		1,173,267
<b>Counterterrorism</b>									
Total Cost	134,362	8,068	32,304	887,281	—	(20)	(40,029)		1,021,966
Earned Revenue	(18,548)	(1,287)	(5,015)	(104,168)	—	(2)	40,029		(88,991)
Net Program Costs	115,814	6,781	27,289	783,113	—	(22)	—		932,975
<b>Homeland Security</b>									
Total Cost	82,189	4,935	19,760	542,745	—	(12)	(24,485)		625,132
Earned Revenue	(11,346)	(787)	(3,067)	(63,719)	—	(1)	24,485		(54,435)
Net Program Costs	70,843	4,148	16,693	479,026	—	(13)	—		570,697
<b>Weapons of Mass Destruction</b>									
Total Cost	76,804	4,612	18,465	507,184	—	(11)	(22,881)		584,173
Earned Revenue	(10,603)	(736)	(2,866)	(59,544)	—	(1)	22,881		(50,869)
Net Program Costs	66,201	3,876	15,599	447,640	—	(12)	—		533,304
<b>International Crime and Drugs</b>									
Total Cost	—	—	2,091,090	43,513	2,335	—	(2,636)		2,134,302
Earned Revenue	—	—	(383,609)	(7,684)	(48)	—	2,636		(388,705)
Net Program Costs	—	—	1,707,481	35,829	2,287	—	—		1,745,597
<b>American Citizens</b>									
Total Cost	—	—	218	940,070	310,764	1,325,456	(195,686)		2,380,822
Earned Revenue	—	—	77	(235,425)	(59,413)	(2,233,163)	195,686		(2,332,238)
Net Program Costs	—	—	295	704,645	251,351	(907,707)	—		48,584
<b>Democracy and Human Rights</b>									
Total Cost	83,071	4,988	19,972	548,575	—	(12)	(24,748)		631,846
Earned Revenue	(11,468)	(796)	(3,100)	(64,403)	—	(1)	24,748		(55,020)
Net Program Costs	71,603	4,192	16,872	484,172	—	(13)	—		576,826
<b>Economic Prosperity and Security</b>									
Total Cost	135,774	8,152	32,643	896,608	—	(20)	(40,450)		1,032,707
Earned Revenue	(18,743)	(1,301)	(5,067)	(105,263)	—	(2)	40,450		(89,926)
Net Program Costs	117,031	6,851	27,576	791,345	—	(22)	—		942,781
<b>Social and Environment Issues</b>									
Total Cost	37,431	2,247	8,999	247,179	—	(6)	(11,151)		284,699
Earned Revenue	(5,167)	(359)	(1,397)	(29,019)	—	—	11,151		(24,791)
Net Program Costs	32,264	1,888	7,602	218,160	—	(6)	—		259,908
<b>Humanitarian Response</b>									
Total Cost	—	—	1,862,410	14,854	234	—	(410)		1,877,088
Earned Revenue	—	—	(527)	(4)	(1)	—	410		(122)
Net Program Costs	—	—	1,861,883	14,850	233	—	—		1,876,966
<b>Public Diplomacy and Public Affairs</b>									
Total Cost	164,201	9,859	39,478	1,084,325	389,867	(24)	(48,918)		1,638,788
Earned Revenue	(22,667)	(1,573)	(6,128)	(127,301)	(56,838)	(2)	48,918		(165,591)
Net Program Costs	141,534	8,286	33,350	957,024	333,029	(26)	—		1,473,197
<b>Executive Direction and Other Costs Not Assigned</b>									
Total Cost	3,879	4,614	79,113	4,688,912	586,250	2,544	(1,883,572)		3,481,740
Earned Revenue	(2,179)	(2,592)	(44,445)	(2,703,434)	(331,657)	(1,429)	1,858,059		(1,227,677)
Net Program Costs	1,700	2,022	34,668	1,985,478	254,593	1,115	(25,513)		2,254,063
<b>Total Cost</b>	886,679	57,620	4,245,076	11,517,051	1,289,450	1,327,870	(2,345,305)		16,978,441
<b>Total Revenue</b>	(124,047)	(11,050)	(461,450)	(3,630,961)	(447,957)	(2,234,603)	2,319,792		(4,590,276)
<b>Total Net Cost</b>	\$ 762,632	\$ 46,570	\$ 3,783,626	\$ 7,886,090	\$ 841,493	\$ (906,733)	\$ (25,513)		\$ 12,388,165

Executive Direction and Other Costs Not Assigned relate to high-level executive direction (e.g., Office of the Secretary, Office of the Legal Adviser), international commissions, general management, and certain administrative support costs that cannot be directly traced or reasonably allocated to a particular program. For the year ended September 30, 2006 and 2005, these consist of costs and earned revenue summarized below (Dollars in Thousands).

Program	2006			2005 (Restated)		
	Total Prior to Eliminations	Intra- Departmental Eliminations	Total	Total Prior to Eliminations	Intra- Departmental Eliminations	Total
<b>Costs:</b>						
Executive Direction	\$ 2,591,920	\$ 588,788	\$ 2,003,132	\$ 2,538,366	\$ 327,607	\$ 2,210,759
FSRDF	1,486,863	397,920	1,088,943	788,524	385,508	403,016
ICASS	1,196,669	894,766	301,903	1,174,812	859,989	314,823
International Commissions	89,860	2,098	87,762	274,089	2,785	271,304
Total Costs	\$ 5,365,312	\$ 1,883,572	\$ 3,481,740	\$ 4,775,791	\$ 1,575,889	\$ 3,199,902
<b>Earned Revenue:</b>						
Executive Direction	\$ 632,366	\$ 588,788	\$ 43,578	\$ 436,405	\$ 327,607	\$ 108,798
FSRDF	1,220,904	372,407	848,497	1,206,883	355,555	851,328
ICASS	1,222,128	894,766	327,362	1,158,916	859,989	298,927
International Commissions	10,338	2,098	8,240	12,873	2,785	10,088
Total Earned Revenue	\$ 3,085,736	\$ 1,858,059	\$ 1,227,677	\$ 2,815,077	\$ 1,545,936	\$ 1,269,141
Total Net Cost for Executive Direction and Other Costs Not Assigned	\$ 2,279,576	\$ 25,513	\$ 2,254,063	\$ 1,960,714	\$ 29,953	\$ 1,930,761

### Program Costs

These costs include the full cost of resources consumed by a program, both direct and indirect, to carry out its activities. Direct costs can be specifically identified with a program. Indirect costs include resources that are commonly used to support two or more programs, and are not specifically identified with any program. Indirect costs are assigned to programs through allocations. Full costs also include the costs of goods or services received from other Federal entities (referred to as inter-entity costs), whether or not the Department reimburses that entity.

Indirect Costs: Indirect costs consist primarily of Management and Organizational Excellence charges for central support functions performed in 2006 and 2005 under the Under Secretary for Management by the following organizations (Dollars in Thousands):

Bureau (or equivalent)	2006	2005 (Restated)
Bureau of Diplomatic Security	\$ 1,282,989	\$ 1,577,271
Office of Overseas Buildings Operations	776,887	905,722
Bureau of Administration	650,511	608,459
Bureau of Information Resource Management	358,036	283,294
Bureau of Personnel	465,596	337,069
Bureau of Resource Management	497,586	287,581
Foreign Service Institute	128,670	127,178
Medical Services and Other	168,849	210,719
Total Central Support Costs	\$ 4,329,124	\$ 4,337,293

These support costs were distributed to programs on the basis of a program's total base salaries for its full-time employees, as a percentage of total base salaries for all full-time employees, except for the Office of Overseas Buildings Operations. Since the Office of Overseas Buildings Operations supports overseas operations, its costs were allocated based on the percentage of budgeted cost by program for the regional bureaus. The distribution of support costs to programs in 2006 and 2005 was as follows (Dollars in Thousands):

Program Receiving Allocation	2006	2005 (Restated)
Regional Stability	\$ 368,493	\$ 368,971
Counterterrorism	293,022	293,403
Homeland Security	179,241	179,473
Weapons of Mass Destruction	167,497	167,714
International Crime and Drugs	47,864	52,415
American Citizens	999,480	992,314
Democracy and Human Rights	181,166	181,401
Economic Prosperity and Security	296,104	296,488
Social and Environmental Issues	81,631	81,737
Humanitarian Response	21	20
Public Diplomacy and Public Affairs	358,097	358,561
Executive Direction and Other Costs Not Assigned	1,356,508	1,364,796
Total	\$ 4,329,124	\$ 4,337,293

Since the cost incurred by the Under Secretary for Management and the Secretariat are primarily support costs, these costs were distributed to the other Under Secretaries to show the full costs under the responsibility segments that have direct control over the Department's programs. One exception within the Under Secretary for Management is the Bureau of Consular Affairs, which is responsible for the American Citizens program. As a result, these costs were not allocated and continue to be reported as the Under Secretary for Management.

The Under Secretary for Management/Secretariat costs (except for the Bureau of Consular Affairs) were allocated to the other Department responsibility segments based on the percentage of total costs by organization for each program. The allocation of these costs to the other Under Secretaries and to the Bureau of Consular Affairs was as follows (Dollars in Thousands):

Under Secretary	2006	2005 (Restated)
Political Affairs	\$ 5,112,736	\$ 4,801,130
Public Diplomacy	710,975	651,315
Management (Consular Affairs)	696,395	694,824
Arms Control, International Security Affairs	336,902	430,691
Global Affairs	1,337,724	207,949
Economic, Business and Agriculture Affairs	29,092	33,506
Total	\$ 8,223,824	\$ 6,819,415

**Inter-Entity Costs and Imputed Financing:** To measure the full cost of activities, SFFAS No. 4, *Managerial Cost Accounting*, requires that total costs of programs include costs that are paid by other U.S. Government entities, if material. As provided by SFFAS No. 4, OMB issued a Memorandum in April 1998, entitled "Technical Guidance on the Implementation of Managerial Cost Accounting Standards for the Government." In that Memorandum, OMB established that reporting entities should recognize inter-entity costs for (1) employees' pension benefits; (2) health insurance, life insurance, and other benefits for retired employees; (3) other post-retirement benefits for retired, terminated and inactive employees, including severance payments, training and counseling, continued health care, and unemployment and workers' compensation under the *Federal Employees' Compensation Act*; and (4) payments made in litigation proceedings.

The Department recognizes an imputed financing source on the Statement of Changes in Net Position for the value of inter-entity costs paid by other U.S. Government entities. This consists of all inter-entity amounts as reported below except for the Federal Workers' Compensation Benefits (FWCB). For FWCB, the Department recognizes its share of the change in the actuarial liability for FWCB as determined by the Department of Labor (DoL). The Department reimburses DoL for FWCB paid to current and former Department employees.

The following inter-entity costs and imputed financing sources were recognized in the Statement of Net Cost and Statement of Changes in Net Position, respectively, for the years ended September 30, 2006 and 2005 (Dollars in Thousands):

Inter-Entity Cost	2006	2005
Other Post-Employment Benefits:		
Civil Service Retirement Program	\$ 24,867	\$ 25,272
Federal Employees Health Benefits Program	91,410	93,648
Federal Employees Group Life Insurance Program	287	269
Litigation funded by Treasury Judgment Fund	—	283
Subtotal – Imputed Financing Source	\$ 116,564	\$ 119,472
Future Workers' Compensation Benefits	16,873	10,198
Total Inter-Entity Costs	\$ 133,437	\$ 129,670

**Intra-departmental Eliminations.** Intra-departmental eliminations of cost and revenue were recorded against the program that provided the service. Therefore the full program cost was reported by leaving the reporting of cost with the program that received the service.



### Earned Revenues

Earned revenues occur when the Department provides goods or services to the public or another Federal entity. Earned revenues are reported regardless of whether the Department is permitted to retain all or part of the revenue. Specifically, the Department collects but does not retain passport, visa, and certain other consular fees. Earned revenues for the year ended September 30, 2006 and 2005, consist of the following (Dollars in Thousands):

Program	2006			2005		
	Total Prior to Eliminations	Intra- Departmental Eliminations	Total	Total Prior to Eliminations	Intra- Departmental Eliminations	Total
Consular Fees:						
Passport, Visa and Other Consular Fees	\$ 882,160	\$ —	\$ 882,160	\$ 826,058	\$ —	\$ 826,058
Machine Readable Visa	693,051	—	693,051	636,478	—	636,478
Expedited Passport	177,853	—	177,853	154,745	—	154,745
Passport, Visa and other Surcharges	188,137	—	188,137	92,345	—	92,345
Fingerprint Processing, Diversity Lottery, and Affidavit of Support	28,414	—	28,414	59,197	—	59,197
Subtotal – Consular Fees	\$ 1,969,615	\$ —	\$ 1,969,615	\$ 1,768,823	\$ —	\$ 1,768,823
FSRDF	\$ 1,220,904	\$ 361,943	\$ 858,961	\$ 1,206,883	\$ 345,581	\$ 861,302
ICASS	1,222,128	894,766	327,362	1,162,774	859,989	302,785
Other Reimbursable Agreements	1,879,580	673,332	1,206,248	1,647,508	591,287	1,056,221
Working Capital Fund	524,274	377,520	146,754	297,410	171,645	125,765
Other	93,568	12,232	81,336	26,894	9,974	16,920
Total	\$ 6,910,069	\$ 2,319,793	\$ 4,590,276	\$ 6,110,292	\$ 1,978,476	\$ 4,131,816

### Pricing Policies

Generally, a Federal agency may not earn revenue from outside sources unless it obtains specific statutory authority. Accordingly, the pricing policy for any earned revenue depends on the revenue's nature, and the statutory authority under which the Department is allowed to earn and retain (or not retain) the revenue. Earned revenue that the Department is not authorized to retain is deposited into the Treasury's General Fund.

The FSRDF finances the operations of the Foreign Service Retirement and Disability System (FSRDS) and the Foreign Service Pension System (FSPS). The FSRDF receives revenue from employee/employer contributions, a U.S. Government contribution, and interest on investments. By law, FSRDS participants contribute 7.25% of their base salary, and each employing agency contributes 7.25%; FSPS participants contribute 1.35% of their base salary and each employing agency contributes 20.22%. Employing agencies report employee/employer contributions biweekly. Total employee/employer contributions for 2006 and 2005 were \$224.0 million and \$214.9 million, respectively.

The FSRDF also receives a U.S. Government contribution to finance (1) FSRDS benefits not funded by employee/employer contributions; (2) interest on FSRDS unfunded liability; and (3) FSRDS disbursements attributable to military service. The U.S. Government contributions for 2006 and 2005 were \$231.3 million and \$225.1 million, respectively. FSRDF cash resources are invested in special

non-marketable securities issued by the Treasury. Total interest earned on these investments in 2006 and 2005 was \$765.6 million and \$766.8 million, respectively.

Consular Fees are established primarily on a cost recovery basis and are determined by periodic cost studies. Reimbursable Agreements with Federal agencies are established and billed on a cost-recovery basis. ICASS billings are computed on a cost-recovery basis; billings are calculated to cover all operating, overhead, and replacement of capital assets, based on budget submissions, budget updates, and other factors. In addition to services covered under ICASS, the Department provides administrative support to other agencies overseas for which the Department does not charge. Areas of support primarily include buildings and facilities, diplomatic security (other than the local guard program), overseas employment, communications, diplomatic pouch, receptionist and selected information management activities. The Department receives direct appropriations to provide this support.

## 17 STATEMENT OF BUDGETARY RESOURCES

The Statement of Budgetary Resources reports information on how budgetary resources were made available and their status as of and for the years ended September 30, 2006 and 2005. Intra-departmental transactions have not been eliminated in the amounts presented.

The Budgetary Resources section presents the total budgetary resources available to the Department. For 2006 and 2005, the Department received approximately \$26.4 billion and \$25.0 billion in budgetary resources, respectively, primarily consisting of the following:

Source of Budgetary Resources	2006	2005
Budget Authority:		
Direct or related appropriations	\$ 16.1 billion	\$ 15.6 billion
Authority financed from Trust Funds	1.3 billion	1.2 billion
Spending authority from providing goods and services	4.4 billion	4.3 billion
Unobligated Balances – Beginning of Year	4.3 billion	3.5 billion
Other	0.3 billion	0.4 billion
Total Budgetary Resources	\$ 26.4 billion	\$ 25.0 billion

The Department received permanent indefinite appropriations of \$42.5 million and \$41.9 million for 2006 and 2005, respectively. The permanent indefinite appropriation provides payments to the Foreign Service Retirement and Disability Fund to finance the interest on the unfunded pension liability for the year and disbursements attributable to military service. The amount of budgetary resources obligated for undelivered orders for all activities as of September 30, 2006 and 2005 was approximately \$10.3 billion and \$8.6 billion, respectively. This includes amounts of \$394 million for September 30, 2006 and \$320 million for September 30, 2005, pertaining to revolving funds, trust funds, and substantial commercial activities.

Information on U.S. Government agencies' budgets is reported in the *Budget of the United States Government, Fiscal Year 2007* – Appendix (*Appendix*). The *Appendix* includes for each agency (including the Department), among other things, budget schedules for the agency's accounts. Information on budgetary resources and their status will be displayed in the *Program and Financing (P&F)* Schedule under each account. Amounts presented in the *P&F Schedules* are in millions of dollars. Each agency is responsible for submitting the data presented in the *P&F Schedules*. Amounts shown on the 2006 Statement of Budgetary Resources will differ from "2006 Actual" reported in the *P&F Schedules* for the Department's accounts as detailed in the schedule on the next page.

The *Appendix* is organized by major subordinate organizations or program areas within the agency, and then by the nature of account(s) (e.g., general, special, revolving, trust) within organization or program area. The Department's section consists of the following areas: Administration of Foreign Affairs, International Organizations and Conferences, International Commissions, Foreign Assistance, and Other. The Combining Schedule of Budgetary Resources appearing as Required Supplementary Information presents amounts in the Combined Statement of Budgetary Resources by these areas.

(Dollars in Millions)

	Budget Authority	Unobligated Balance Beginning of Year	Unobligated Balance End of Year	Obligations Incurred	Obligated Balance Beginning of Year	Obligated Balance End of Year	Net Outlays	Offsetting Receipts
<b>FY 2006:</b>								
International Security Assistance Programs	1,211	446	356	1,442	854	860	1,321	—
Undelivered Orders Adjustment	—	—	397	(187)	—	(397)	—	—
Expired Accounts Unobligated Balances	—	232	291	262	1,475	600	703	—
Undistributed Offsetting Receipts	—	—	—	—	—	—	—	861
Total FY 2006 Differences	1,211	678	1,044	1,517	2,329	1,063	2,024	861
<b>FY 2005:</b>								
International Security Assistance Programs	1,268	489	445	1,628	952	854	1,395	—
Undelivered Orders Adjustment	—	—	333	—	—	(333)	—	—
Expired Accounts Unobligated Balances	—	216	286	696	2,105	697	1,648	—
Undistributed Offsetting Receipts	—	—	—	—	—	—	—	911
Total FY 2005 Differences	1,268	705	1,064	2,324	3,057	1,218	3,043	911

The Statement of Budgetary Resources includes amounts the Department received in 2006 and 2005 to administer programs related to International Security Assistance. Amounts for these programs are not directly presented under the Department in the Appendix, but are reported in the Appendix under the section titled International Assistance Programs. In addition, the Statement of Budgetary Resources includes amounts of unavailable unobligated and obligated balances (primarily for expired annual accounts) that will not be reported in the Appendix. These unavailable unobligated balances in expired accounts (2005 and prior) remain available for adjustment, liquidation of obligations and other purposes authorized by law, until such accounts are closed as required by law and any remaining amounts will be returned to the General Fund of the U.S. Treasury. However, they are not available to incur new obligations since their period of availability to do such has expired.

## 18 CONSOLIDATED STATEMENT OF FINANCING

Accrual-based measures used in the Statement of Net Cost differ from the obligation-based measures used in the Statement of Budgetary Resources. The Statement of Financing for the years ended September 30, 2006 and 2005, presents information to reconcile these different measures. In doing so, the Statement of Financing provides assurance that the financial information is consistent with similar amounts found in budget reports. The Statement of Financing reconciles obligations of budget authority to the accrual-based net cost of operations. The Net Cost of Operations as presented on the Statement of Financing is determined by netting the obligations as adjusted and non-budgetary resources and making adjustments for the total resources that do not fund net cost of operations, the total costs that do not require resources, and financing sources yet to be provided. The result is Net Cost of Operations as reported on the Statement of Net Cost.

## 19 CUSTODIAL ACTIVITY

The Department administers certain activities associated with the collection of non-exchange revenues, which are deposited and recorded directly to the General Fund of the Treasury. The Department does not retain the amounts collected. Accordingly, these amounts are not considered or reported as financial or budgetary resources for the Department. At the end of each fiscal year, the accounts are closed and the balances are brought to zero by Treasury. Specifically, the Department collects interest, penalties and handling fees on accounts receivable; fines, civil penalties and forfeitures; and other miscellaneous receipts. In 2006 and 2005, the Department collected \$37.2 million and \$15.3 million, respectively, in custodial revenues that were transferred to the Treasury.

## 20 RESTATEMENTS

The accompanying FY 2005 financial statements have been restated, as described below, to correct errors with respect to the accounting for certain real property transactions. The effect of the restatement was to decrease Total Net Cost for 2005 by \$160.7 million. Cumulative Results of Operations at the beginning of 2005 has been adjusted for the effects of the restatement on prior years. The restatement had no effect on the Statement of Budgetary Resources or the President's Budget.

In the course of the Department's first-year efforts to implement Appendix A, Internal Control Over Financial Reporting, of OMB's Circular A-123, *Management's Responsibility for Internal Control*, we identified errors in previously reported amounts for real property and associated depreciation and operating expenses as follows.

- ◆ Not identifying and adjusting completed capital projects in a timely manner.
  - Amounts reported as construction-in-progress where the projects had been completed and should have been reclassified to Buildings and Structures and the associated depreciation expense recorded.
- ◆ Expensing capital project costs.
  - Amounts reported as expense for capital projects that should have been recorded to construction-in-progress.

Significant awareness was raised about the importance of the internal controls related to these activities, and a number of corrective actions were taken to strengthen processes and controls to preclude future errors of this nature. For example, procedural guidance was developed, documented and implemented. In addition, processes were established to monitor outstanding projects on a periodic basis for the purpose of identifying any projects that are being improperly expensed, or that are complete but not reclassified to buildings and structures. Also, the Department's on-going A-123 Appendix A program will annually test the controls related to these activities to ensure they are in place and operating effectively.

**Consolidated Balance Sheet:**

	As of September 30, 2005		
	As Previously Reported	Adjustment	As Restated
Property and Equipment, Net	\$ 7,244,965	\$ 617,647	\$ 7,862,612
Total Assets	\$ 35,737,346	\$ 617,647	\$ 36,354,993
Cumulative Results of Operations	\$ 7,226,709	\$ 617,647	\$ 7,844,356
Total Net Position	\$ 18,657,348	\$ 617,647	\$ 19,274,995

**Consolidated Statement of Net Cost:**

	For the Year Ended September 30, 2005		
	As Previously Reported	Adjustment	As Restated
Total Cost	\$ 16,114,593	\$ (160,672)	\$ 15,953,921
Total Net Cost	\$ 11,982,777	\$ (160,672)	\$ 11,822,105

**Consolidated Statement of Changes in Net Position:**

	For the Year Ended September 30, 2005		
	As Previously Reported	Adjustment	As Restated
Cumulative Results of Operations:			
Beginning Balances	\$ 6,312,138	\$ 456,975	\$ 6,769,113
Net Cost of Operations	\$ (11,982,777)	\$ 160,672	\$ (11,822,105)
Ending Balances	\$ 7,226,709	\$ 617,647	\$ 7,844,356

**Combined Statement of Budgetary Resources:** No Effect



State Secretary of the German Foreign Office Klaus Scharioth, German Minister of the Interior Otto Schily, Ambassador of the United States in Germany Daniel Coats, Director of Overseas Buildings Operations of the U.S. Department of State Charles Williams and the Governing Mayor of Berlin Klaus Wowereit, from left, during the groundbreaking ceremony of the new U.S. Embassy next to the Brandenburg Gate in Berlin. © AP/ Wide World



**Consolidated Statement of Financing:****For the Year Ended September 30, 2005**

	<b>As Previously Reported</b>	<b>Adjustment</b>	<b>As Restated</b>
Resources that finance the acquisition of assets	\$ 1,390,661	\$ 257,978	\$ 1,648,639
Total Resources Used to Finance Items not Part of the Net Cost of Operations	\$ 2,463,098	\$ 257,978	\$ 2,721,076
Total Resources Used to Finance the Net Cost of Operations	\$11,811,664	\$ (257,978)	\$ 11,553,686
Depreciation and Amortization	\$ 500,503	\$ 97,306	\$ 597,809
Total Components of Net Cost of Operations that will not Require or Generate Resources	\$ (483,351)	\$ 97,306	\$ (386,045)
Total Components of Net Cost of Operations that will not Require or Generate Resources in the Current Period	\$ 171,113	\$ 97,306	\$ 268,419
Net Cost of Operations	\$11,982,777	\$ (160,672)	\$ 11,822,105

**Footnote 8, Property and Equipment, Net:****As of September 30, 2005**

	<b>As Previously Reported</b>	<b>Adjustment</b>	<b>As Restated</b>
Real Property - Overseas:			
Land and Land Improvements:			
Cost	\$ 1,982,304	\$ 4,666	\$ 1,986,970
Accumulated Depreciation	\$ (272)	\$ (847)	\$ (1,119)
Net Value	\$ 1,982,032	\$ 3,819	\$ 1,985,851
Buildings and Structures:			
Cost	\$ 4,362,838	\$ 1,581,438	\$ 5,944,276
Accumulated Depreciation	\$ (2,642,525)	\$ (222,138)	\$ (2,864,663)
Net Value	\$ 1,720,313	\$ 1,359,300	\$ 3,079,613
Construction-in-Progress:			
Cost	\$ 2,165,515	\$ (825,591)	\$ 1,339,924
Accumulated Depreciation	—	\$ —	\$ —
Net Value	\$ 2,165,515	\$ (825,591)	\$ 1,339,924
Leasehold Improvements:			
Cost	\$ 74,985	\$ 138,695	\$ 213,680
Accumulated Depreciation	\$ (27,068)	\$ (58,576)	\$ (85,644)
Net Value	\$ 47,917	\$ 80,119	\$ 128,036
Subtotal – Real Property			
Cost	\$ 9,327,032	\$ 899,208	\$ 10,226,240
Accumulated Depreciation	\$ (2,920,212)	\$ (281,561)	\$ (3,201,773)
Net Value	\$ 6,406,820	\$ 617,647	\$ 7,024,467
Total Property and Equipment, Net			
Cost	\$ 10,909,121	\$ 899,208	\$ 11,808,329
Accumulated Depreciation	\$ (3,664,156)	\$ (281,561)	\$ (3,945,717)
Net Value	\$ 7,244,965	\$ 617,647	\$ 7,862,612



## REQUIRED SUPPLEMENTARY INFORMATION

DEPARTMENT OF STATE  
**COMBINING SCHEDULE OF BUDGETARY RESOURCES**  
 For the Year Ended September 30, 2006  
 (Dollars in Thousands)

	Administration of Foreign Affairs	International Organizations	International Commissions	Foreign Assistance	Other	Total
<b>Budgetary Resources:</b>						
Unobligated Balance, brought forward, October 1:	\$ 2,969,425	\$ 326	\$ 9,263	\$ 491,809	\$ 800,284	\$ 4,271,107
Recoveries of Prior Year Unpaid Obligations	746,590	8,665	2,044	10,582	66,987	834,868
Budget Authority:						
Appropriations	9,429,296	2,331,512	67,339	1,210,057	4,331,982	17,370,186
Borrowing Authority	378	—	—	—	—	378
Contract Authority	—	—	—	—	—	—
Spending authority from offsetting collections (gross):						
Earned						
Collected	4,163,036	—	6,066	40,342	483,651	4,693,095
Change in receivable from Federal sources	(394,658)	—	78	(420)	(126,627)	(521,627)
Change in unfilled customer orders:						
Advance received	—	—	25	(3,211)	267,425	264,239
Without Advance from Federal Sources	—	—	(751)	—	1	(750)
Anticipated for rest of year, without advance	—	—	—	—	—	—
Previously unavailable	—	—	—	—	—	—
Expenditure transfers from trust funds:	—	—	—	—	—	—
Nonexpenditure transfers, net, anticipated and actual	15,652	—	—	51,800	123,774	191,226
Temporarily not available pursuant to Public Law	(376,869)	—	—	—	—	(376,869)
Permanently not available	(189,976)	(33,496)	(2,050)	(25,630)	(41,740)	(292,892)
<b>Total Budgetary Resources</b>	<b>16,362,874</b>	<b>2,307,007</b>	<b>82,014</b>	<b>1,775,329</b>	<b>5,905,737</b>	<b>26,432,961</b>
<b>Status of Budgetary Resources:</b>						
Obligations Incurred:						
Direct	8,103,317	2,177,139	69,117	1,376,275	4,369,344	16,095,192
Reimbursable	4,320,682	—	5,801	43,037	681,101	5,050,621
Unobligated balance						
Apportioned	3,541,530	129,883	5,940	351,140	733,647	4,762,140
Exempt from apportionment	33,409	—	—	—	7,454	40,863
Unobligated balance not available	363,936	(15)	1,156	4,877	114,191	484,145
<b>Total Status of Budgetary Resources</b>	<b>\$ 16,362,874</b>	<b>\$ 2,307,007</b>	<b>\$ 82,014</b>	<b>\$ 1,775,329</b>	<b>\$ 5,905,737</b>	<b>\$ 26,432,961</b>

DEPARTMENT OF STATE  
**COMBINING SCHEDULE OF BUDGETARY RESOURCES** *continued*  
 For the Year Ended September 30, 2006  
 (Dollars in Thousands)

	Administration of Foreign Affairs	International Organizations	International Commissions	Foreign Assistance	Other	Total
<b>Change in Obligated Balance:</b>						
Obligated Balance, net						
Unpaid Obligations, brought forward, October 1	5,558,272	72,516	23,079	796,472	3,828,723	10,279,062
Less: Uncollected customer payments from Federal sources, brought forward, October 1	(760,908)	67	(4,217)	(3,420)	(170,092)	(938,570)
Obligations incurred, net	12,423,999	2,177,139	74,918	1,419,312	5,050,445	21,145,813
Gross Outlays	(11,863,732)	(2,023,095)	(73,908)	(1,356,916)	(4,077,333)	(19,394,984)
Obligated balance transfers, net						
Actual transfers, unpaid obligations		—	—	—	—	—
Actual transfers, uncollected customer payments from Federal sources	—	—	—	—	—	—
Less: Recoveries of prior-year unpaid obligations, actual	(746,590)	(8,665)	(2,044)	(10,582)	(66,987)	(834,868)
Change in uncollected customer payments from federal sources	394,658	—	673	420	126,627	522,378
Obligated balance, net, end of period:						
Unpaid obligations	5,371,949	217,895	22,046	848,286	4,734,847	11,195,023
Less: Uncollected customer payments from Federal sources	(366,250)	67	(3,545)	(3,000)	(43,464)	(416,192)
Net Outlays						
Gross outlays	11,863,732	2,023,095	73,908	1,356,916	4,077,333	19,394,984
Less: Offsetting collections	(4,163,036)	—	(6,090)	(37,131)	(751,077)	(4,957,334)
Less: Distributed Offsetting receipts	(249,095)	—	—	—	(1,725)	(250,820)
<b>Net Outlays</b>	<b>7,451,601</b>	<b>2,023,095</b>	<b>67,818</b>	<b>1,319,785</b>	<b>3,324,531</b>	<b>14,186,830</b>

## HERITAGE ASSETS

### FOR THE FISCAL YEARS ENDED SEPTEMBER 30, 2006 AND 2005

The Department has collections of art objects, furnishings, books, and buildings that are considered heritage or multi-use heritage assets. These collections are housed in the Diplomatic Reception Rooms, senior staff offices in the Secretary's suite, offices, reception areas, conference rooms, the cafeteria and related areas, and embassies throughout the world. The items have been acquired as donations, are on loan from the owners, or were purchased using gift and appropriated funds. The assets are classified into six categories: the Diplomatic Reception Rooms, Art Bank, Art in Embassies, Curatorial Services Program, Library Rare & Special Book Collection, and Secretary of State's Register of Culturally Significant Property. Items in the Register of Culturally Significant Property category are classified as multi-use heritage assets due to their use in general government operations.

#### Diplomatic Reception Rooms

Under the management of the Curator's Office, the Diplomatic Reception Room collection is comprised of museum-caliber American furnishings from the 1750 to 1825 period. These items are used to decorate the Diplomatic Reception Rooms located on the 8th floor of the Department of State, as well as 19 offices on the 7th floor used by the Secretary of State and the Secretary's senior staff. These items have been acquired through donations or purchases funded through gifts from private citizens, foundations, and corporations. Tax dollars have not been used to acquire or maintain the collection.

*Philadelphia mahogany table-desk on which Thomas Jefferson drafted the Declaration of Independence.*



Photo: Richard Cheek



*Thomas Jefferson State Reception Room.*



*The Benjamin Franklin State Dining Room.*

Photo: Richard Cheek

## Art Bank

The Art Bank was established in 1984 to acquire artworks that could be displayed throughout the Department's offices and annexes. The works of art are displayed in staff offices, reception areas, conference rooms, the cafeteria, and related public areas. The collection consists of original works on paper (watercolors and pastels) as well as limited edition prints, such as lithographs, woodcuts, intaglios, and silk-screens. These items are acquired through purchases funded by contributions from each participating bureau.



*Volkmar Wentzel  
(clockwise from top left)  
U.S. Capitol  
The Washington Monument  
Q Street Bridge  
Pennsylvania Avenue*



## Rare & Special Book Collection

In recent years, the Library has identified books that require special care or preservation. Many of these publications have been placed in the Rare Books and Special Collections Room, which is located adjacent to the Reading Room. Among the treasures is a copy of the Nuremberg Chronicles, which was printed in 1493; volumes signed by Thomas Jefferson; and books written by Foreign Service authors.

## Curatorial Services Program

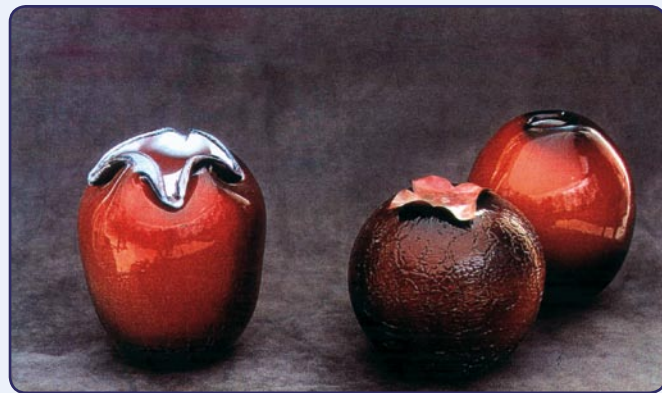
The Curatorial Services Program, which is managed by Overseas Buildings Operations, Interiors & Furnishings Division, Program Management Branch, is responsible for identifying and maintaining cultural objects owned by the Department of State in its properties abroad. The collections are identified based upon their historic importance, antiquity, or intrinsic value.



## Art in Embassies

The Art in Embassies Program was established in 1964 to promote national pride and the distinct cultural identity of America's arts and its artists. The program, which is managed by the Bureau of Overseas Buildings Operations, provides original U.S. works of art for the representational rooms of United States ambassadorial residences worldwide. The works of art were purchased or are on loan from individuals, organizations, or museums.

1. Jerry Hovanec, *Persimmon with Pulled Stem-Cap* 1998, *Persimmon with Copper Stem-Cap* 1997, and *Untitled/Persimmon Vessel* 1997, (17 x 13 x 13 cm) blown glass. Courtesy of the artist, Lusby, Maryland



## Secretary of State's Register of Culturally Significant Property

The Secretary of State's Register of Culturally Significant Property was established in January 2001 to recognize the Department's owned properties overseas, which have historical, architectural, or cultural significance. Properties in this category include chanceries, consulates, and residences. All these properties are used predominantly in general government operations and are thus classified as multi-use heritage assets. Financial information for multi-use heritage assets is presented in the principal statements.



Situated adjacent to Regent's Park in London, England, Winfield House is the residence of the U.S. Ambassador to the Court of St. James. Heiress Barbara Hutton built this country manor in 1936, and named it after her grandfather F.W. (Winfield) Woolworth, who had founded the famous Woolworth stores where any item could be purchased for five or ten cents. After World War II, Hutton offered the building to the United States Government to use as the ambassador's residence for the price of one American dollar.

HERITAGE ASSETS For Years Ended September 30, 2003 through 2005						
	Diplomatic Reception Rooms Collection	Art Bank	Art in Embassies Program	Curatorial Services Program	Library Rare & Special Book Collection	Secretary of State's Register of Culturally Significant Property
Description	Collectibles – Art and furnishings from the period 1750 to 1825	Collectibles – American works of art	Collectibles – American works of art	Collections include fine and decorative arts and other cultural objects.	Collectibles – Rare books and other publications of historic value	Noncollection – Buildings of historic, cultural, or architectural significance
Acquisition and Withdrawal	Acquired through donation or purchase using donated funds. Excess items are sold.	Acquired through purchase. Excess items are sold.	Acquired through purchase or donation. Excess items are sold.	The program provides assessment, preservation, and restoration as needed	Acquired through purchase or donation. Excess items are sold.	Acquired through purchase. Excess items are sold.
Condition	Good to excellent	Good to excellent	Good to excellent	Good to excellent	Good to excellent	Poor to Excellent
Number of Items – 09/30/2004	3,411	2,169	975	4,468	1,033	8
Acquisitions	2	46	5	8	—	—
Adjustments	—	(72)	2	—	—	—
Disposals	—	—	3	1	—	—
Number of Items – 09/30/2005	3,413	2,143	979	4,475	1,033	8
Deferred Maintenance – 09/30/2005	N/A	N/A	N/A	N/A	N/A	\$4,459,522
Acquisitions	8	22	—	74	—	—
Adjustments	—	—	—	—	—	9
Disposals	—	—	—	8	—	—
Number of Items – 09/30/2006	3,421	2,165	979	4,541	1,033	17
Deferred Maintenance – 09/30/2006	N/A	N/A	N/A	N/A	N/A	\$2,716,714



## DEFERRED MAINTENANCE FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 2006

The Department occupies more than 3,000 government-owned or long-term leased real properties at more than 260 overseas locations. It uses a condition assessment survey method to evaluate the asset's condition, and determine the repair and maintenance requirements for its overseas buildings.

SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, requires that deferred maintenance (measured using the condition survey method) and the description of the requirements or standards for acceptable operating condition be disclosed. Fundamentally, the Department considers all of its overseas facilities to be in an "acceptable condition" in that they serve their required mission. Adopting standard criteria for a classification of acceptable condition is difficult due to the complex environment in which the Department operates.

From a budgetary perspective, funding for maintenance and repair has been insufficient in the past. As a result, the Department has identified current maintenance and repair backlog of \$325.8 million for buildings and facilities-related equipment and heritage assets that have not been funded. This figure is less than the \$521.4 million reported for 2005 as a result of transferring function code 7911 projects from maintenance tracking to their long range facilities plan. By doing this, the maintenance is no longer deferred but rather is now scheduled for construction. The current estimate is a more realistic measure of maintenance and repair work that must be done to buildings and equipment to bring them up to where the Department believes they should be.

# Supplemental Information and Other Reporting Requirements

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## FINANCIAL MANAGEMENT PLANS AND REPORTS

## OVERVIEW

## INTRODUCTION

The Department's Bureau of Resource Management (RM), headed by the Assistant Secretary for Resource Management and Chief Financial Officer (CFO), employs over 500 people around the globe—in Washington, Charleston, South Carolina, and Bangkok, Thailand. With five major operating units, the CFO oversees all strategic and performance planning, State operations and foreign assistance budgeting and resource management, global accounting, disbursing and payroll, financial systems, and issuance of the financial statements and "annual report" of the Department. The CFO also coordinates and leads the remediation of vulnerabilities within the Department's global critical infrastructure. RM produces a number of essential documents including the Joint State/USAID Strategic Plan, Department Performance Plan, Performance and Accountability Report, Budget-in-Brief, and the Congressional Budget Justification Document.

RM's customers are all embassies, consulates, and missions overseas, nearly 40 other U.S. Government agencies overseas, all domestic bureaus and employees of the State Department, and the Broadcasting Board of Governors. RM's services to its customers are critical in order that they can do their job to create a more secure, democratic, and prosperous world.

## MISSION

*"To integrate strategy, budgeting, and performance management, and secure and manage the resources necessary to accomplish the Department of State's mission."*

The CFO's mission statement is incorporated into the Department's strategic goal for Management and Organizational Excellence as Performance Goal 5. This Performance Goal has two initiatives, one each for the President's Management Agenda's initiatives for Improved Financial Performance and Budget and Performance Integration.

## IMPROVED FINANCIAL PERFORMANCE

## GOALS AND STRATEGIES

## INITIATIVE GOAL STATEMENT

*Provide world-class financial services that support strategic decision-making, mission performance, the President's Management Agenda, and improved accountability to the American people.*

Improving financial performance means that the Department knows where every dollar comes from and where every dollar goes in a timely and accurate manner. Accurate and timely information is critical to managing our programs on a day-to-day basis, obtaining the best performance, and ensuring accountability to the American public. It is also a core competency of world-class organizations.

To do this, RM will:

- Produce on-time, accurate and useful financial statements on a routine basis.
- Obtain an unqualified ("clean") opinion on annual Departmentwide financial statements.
- Produce award winning Performance and Accountability Reports.
- Implement seamless financial systems and processes that meet Federal and Department requirements.
- Ensure effective internal controls are in place and functioning.
- Consolidate and standardize financial operations.
- Leverage best business practices and electronic technologies (E-Gov).
- Build a top-notch finance team.
- Undertake other value-added activities that support strategic decision-making and mission performance.

Key measures of our success in this area are aligned with how OMB scores financial management related to achieving a "green" status rating on the President's Management Agenda. Other measures of success include:

- Are we implementing the President's mandate to effectively adopt E-Gov solutions, especially in the areas of payroll, travel and grants?
- Are we adequately investing in our greatest asset – our people?

## PERFORMANCE

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During FY 2006, the Department satisfied all nine of the criteria and achieved and maintained a "Green" status score for improved financial performance.

OMB-ESTABLISHED CRITERIA	
Criteria	Status
Receives an unqualified audit opinion on its annual financial statements.	Met
Meets financial statement reporting deadlines.	Met
Reports in its audited annual financial statements that its systems are in compliance with the Federal Financial Management Improvement Act.	Met
Has no chronic or significant Anti- Deficiency Act Violations.	Met
Has no material auditor-reported internal control weaknesses.	Met
Has no material non-compliance with laws or regulations.	Met
Has no material weaknesses or non-conformances reported under Section 2 and Section 4 of the Federal Managers' Financial Integrity Act that impact the agency's internal control over financial reporting or financial systems.	Met
Currently produces accurate and timely financial information that is used by management to inform decision-making and drive results in key areas of operations.	Met (Improved)
Is implementing a plan to continuously expand the scope of its routine data use to inform management decision-making in additional areas of operations.	Met (Improved)

## Customer Service

Customer service is the hallmark of the Bureau of Resource Management. As the Department moves to a single world-class financial system, RM has redoubled its emphasis on customer service and support. The Overseas Post Support Desk, in addition to helping posts with implementation of new financial systems and changes, has been expanded to become a state-of-the-art help desk for financial management professionals in the Department and in other agencies we service. As part of this effort, RM is moving the customer support function towards a 24/7 operation, leveraging our presence in time zones roughly equidistant around the globe (Charleston, Bangkok and Paris), and integrating former Washington-based operations into our customer support regime. For example, the former American Payroll Resolution Center is now operational in Charleston.

## Building a Top-Notch Finance Team

Establishing a worldwide cadre of qualified financial managers presents a difficult challenge to the CFO. Unlike most other Government agencies, the CFO must manage the dynamics of three personnel systems that include financial management personnel: Foreign Service, Civil Service and Foreign Service Nationals (FSNs). Our primary strategy is to maintain a vigorous and active training program for financial management practitioners. We view the training program as critical — in implementing new systems, establishing RM as the lead bureau within the Department on financial management issues, and also in ensuring that information in the field is current and authoritative. In 2006, the training program was strengthened to provide overseas customers a full line-up of training opportunities — offering over 100 separate courses, for a total of 1,600 training seats available in 14 different locations around the globe. Our training program enjoys customer approval ratings in excess of 90 percent.

## THE ROAD AHEAD

Looking ahead, State will continue to achieve fundamental “compliance” results. Moving beyond compliance-based results, State management is making decisions based on meaningful financial information to achieve better performance results in the form of lower costs, improved efficiencies and/or improved outcomes for agency mission.

State will also undertake other value added activities that support effective strategic decision-making and mission performance. These activities include:

- **Enhancing management and internal controls.** The Department maintains a robust system of management controls overseen by senior leadership and administered by RM. The Department’s strong commitment to management controls has served as a positive catalyst for change and there are no material weaknesses reported under FMFIA. Recent events in the private sector have increased concerns related to financial management, and in particular on internal controls. To address these concerns, Congress passed the Sarbanes-Oxley Act of 2002, which establishes new demands for corporate accountability and includes several important sections related to internal controls for public companies. In December 2004, OMB revised Circular A-123, *Management’s Responsibility for Internal Control*, to strengthen internal control in the Federal government. The Department fully implemented the requirements of revised circular A-123 in FY 2006, as required.
- **Streamlining and consolidating global financial operations.** In FY 2005, State completed a multi-year effort to consolidate and streamline our worldwide financial operations in our Charleston, South Carolina and Bangkok, Thailand locations
- **Leveraging best business practices and electronic technologies (E-Gov).** The Department has selected and will soon begin implementation of an electronic Travel (eTS) program, beginning with our overseas locations. The program was piloted at several overseas locations in FY 2006. In addition, working with the Department of Agriculture’s National Finance Center, State will reach a plan for migrating its current Consolidated American Payroll Processing System (that pays both civil service and foreign service employees).
- **Partnering with other Federal agencies.** The Joint Financial Management System (JFMS) investment is a cooperative effort by the Department of State and USAID to improve service and save money through collaboration on financial systems and functions. USAID and State are working together to migrate from two separate financial systems operations that use commercial off-the-shelf (COTS) software and different technical architectures to a common technical environment. The end goal of the JFMS is to create a common financial systems platform for State and USAID to manage all domestic and overseas financial management activities.

## FINANCIAL MANAGEMENT SYSTEMS

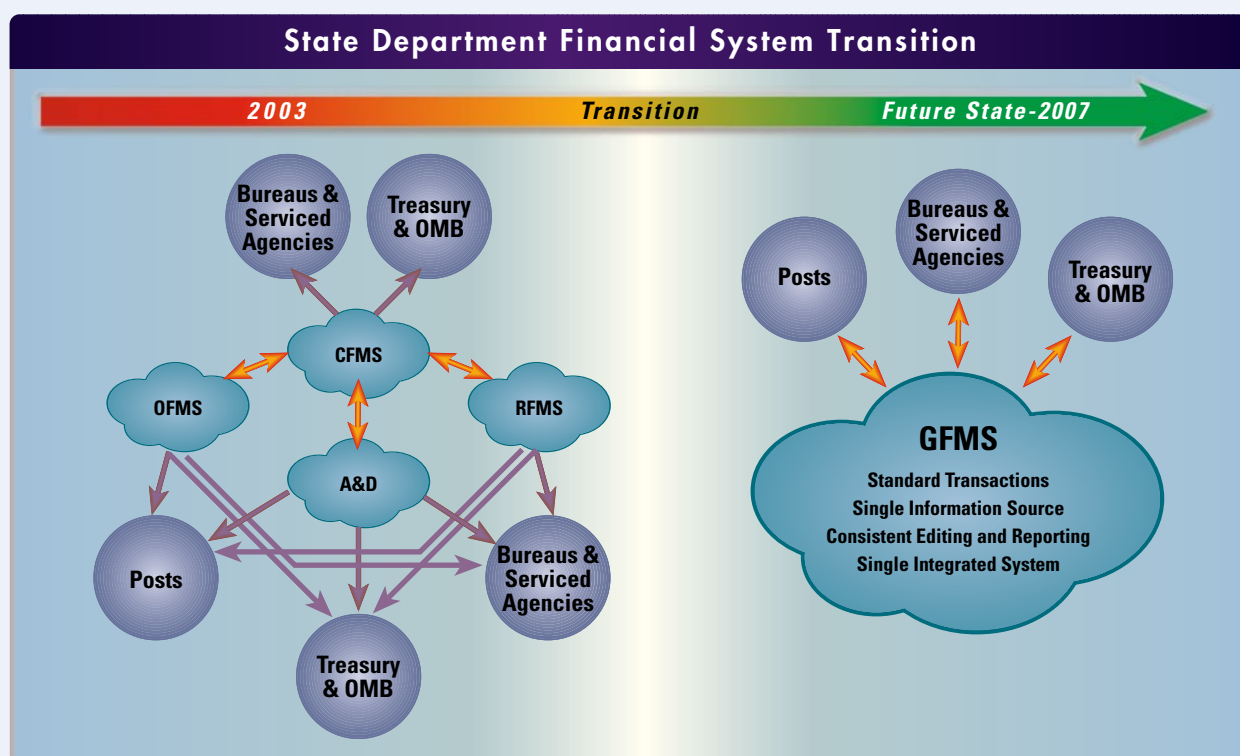
### IMPLEMENT A GLOBAL FINANCIAL MANAGEMENT SYSTEM (GFMS)

For the past two decades, the Department accounted for its resources through multiple outdated and disjointed legacy financial systems. Some posts effectively conducted operations through the integration of little more than a collection of Excel spreadsheets. Often, it could take up to 45 days after a financial event occurred for overseas financial data to update the Department’s Central Financial Management System (CFMS).



The Global Financial Management System (GFMS) project integrates the Department's overseas and domestic financial operations onto common financial management software platform in Charleston. The GFMS program replaces the Department's 20-year-old overseas systems and legacy mainframe systems with modern open systems technology and COTS federally certified software. The platform will provide a single integrated view of financial data through data standardization, common business processes, and the seamless exchange of information through the Department's financial and administrative sectors. This will dramatically improve operations and reduce costs by eliminating system redundancies and replacing obsolete and unsupported financial systems. It will also provide the infrastructure for integrating other administrative activities within the Department, such as the Integrated Logistics Management System (ILMS).

The diagram below depicts the state of our financial systems at the beginning of FY 2003 and the end state of our global vision for the beginning of FY 2007 and beyond.



The following implementations will become the Department's Global Financial Management System.

### Regional Financial Management System (RFMS)

RFMS is the new global accounting and disbursing system that has been implemented for posts around the world, and the building block of GFMS. RFMS is comprised of a commercial-off-the-shelf, accounting system for funds management, obligation, and voucher processing, and the RFMS/D disbursing system developed by the Department for Treasury disbursing services. The successful worldwide implementation of RFMS replaced the obsolete Paris Accounting and Disbursing system (mainframe-based) used at FSC Paris and the Overseas Financial Management System (Wang-based) used at FSCs Charleston and Bangkok. RFMS incorporates State's standard account structure and improves transaction standardization and timeliness between RFMS and CFMS, which results in the consistent, timely processing and recording of financial data on a worldwide basis. In addition, the overseas interface was

reengineered for RFMS and now provides daily updates of overseas financial transactions to CFMS. These daily updates allow headquarters managers to ascertain the worldwide balance of our accounts on a daily basis, something never before possible.

In addition, RM enhanced its reporting tool called COAST which provides daily updates on all financial transactions to 168 posts overseas and domestic bureaus, allowing them to analyze, and “slice and dice” their financial data for local reporting purposes using modern reporting and query tools on their local workstation.

### **Central Financial Management System (CFMS)**

CFMS is the Department’s primary and central accounting system in Washington. It is a mainframe-based COTS product that will be upgraded to the same COTS software used by RFMS software in FY 2007. Upon completion of this conversion, the Department will have in place a worldwide core financial management system on a common software platform.

### **Global Direct Connect**

Global Direct Connect will move posts that have operationally practical and reliable network connections (estimated at over 85 percent of our embassies) from their current batch processing environment to a real time, on line connection with GFMS. Currently, there are 59 posts using Global Direct Connect. Our plan is to implement another 39 more posts to Global Direct Connect by the end of FY 2007.

### **Becoming a Financial Line of Business Center of Excellence**

In FY 2004, the Administration asked agencies with the skills and capabilities to function as government-wide service providers in the area of Financial Management to submit business cases for doing so as part of the Fiscal Year 2006 budget process. After assessing potential service providers in several areas, including but not limited to past performance, current capabilities, and ability to operate a customer-focused organization, four agencies were designated Financial Management (FM) Line of Business (LoB) Service Centers.

Recognizing that the offerings of these four service providers were geared toward domestic operations, the Department prepared a FY08 Exhibit 300 business case as well as an accompanying proposal to become a service center of excellence for foreign affairs agencies. The Department welcomes this opportunity to continue to service the foreign affairs community and further the President’s Management Agenda.

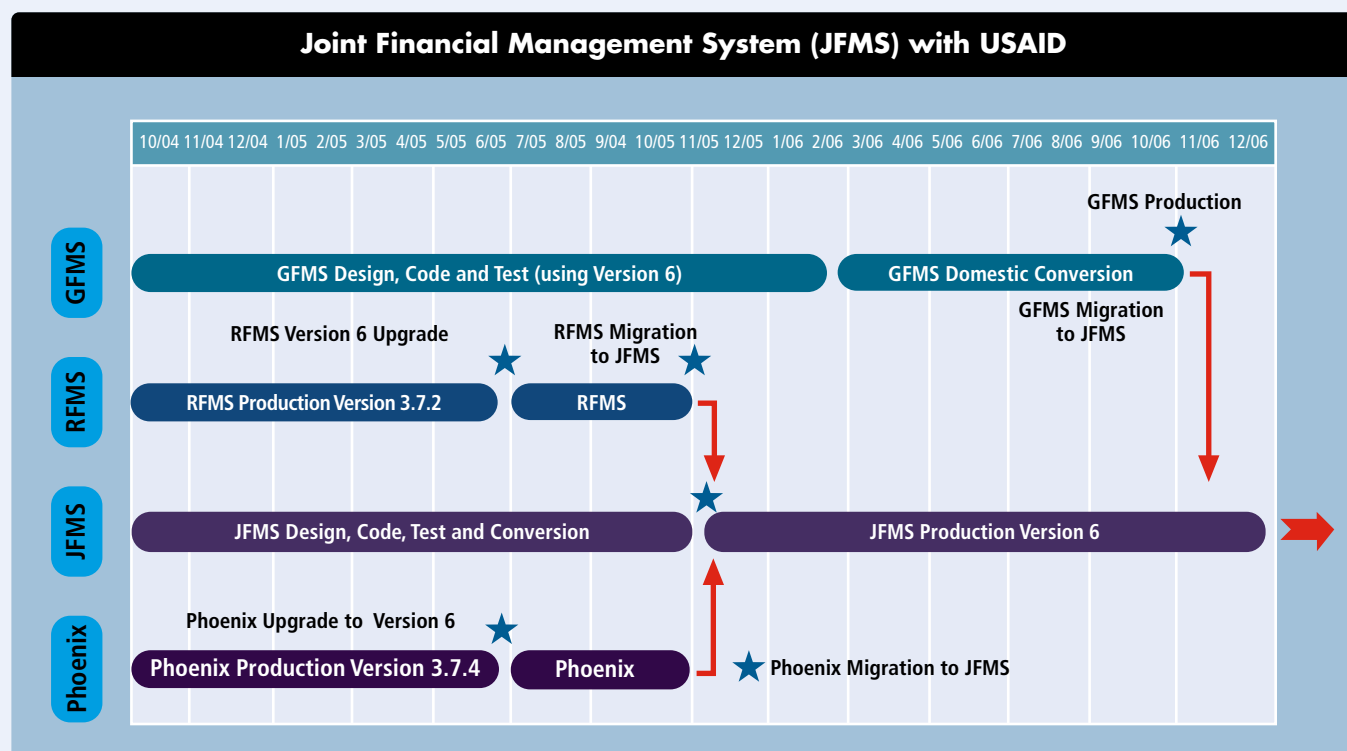
### **Joint Financial Management System (JFMS) with USAID**

The Joint Financial Management System (JFMS) investment is a cooperative effort by the Department of State and the U.S Agency for International Development (USAID) to improve service and save money through collaboration on financial systems and functions. At issue was the pursuit of separate implementations of the same financial system software (CGI-AMS’ Momentum) when a joint effort would improve efficiency based on economies of scale.

At the beginning of FY 2006, State and USAID achieved their goal of creating a common financial systems platform for State and USAID to manage financial management activities with the successful move of the USAID financial management system to the State

Department's Charleston Financial Services Center. The JFMS investment combines the Department's Global Financial Management System (GFMS) and USAID Phoenix investments onto a common financial management platform.

The diagram below depicts the state of our financial systems at the beginning of FY 2003 and the end state of our global vision for FY 2007.



### Joint Assistance Management System (JAMS) with USAID

USAID and the Department of State are implementing a Joint Assistance Management System (JAMS). The system will collect assistance information and will interface with the Joint Financial Management System being implemented by the two agencies. JAMS will be based on a commercial product called "Grantium." Grantium was selected from a field of commercial products because of its ability to be easily configured for assistance processes. Other features include a robust reporting capability.

During FY 2006 significant progress was made on JAMS. Assistance processes were reconciled between State and USAID. A proof of concept was conducted with support from both domestic and field users of Grantium. The Grantium solution was presented to the government-wide Grants Executive Board which recommended continued development by USAID and State.

FY 2007 will see a second proof of concept to evaluate changes and upgrades resulting from the suggestions in the first session. Pilot deployments will begin in the fourth quarter, setting the stage for domestic rollout in FY 2008. State and USAID teams continue excellent collaboration on the Grantium effort.

## MANAGEMENT OF OBLIGATIONS TO THE DEPARTMENT

## DEBT MANAGEMENT

Outstanding debt from non-Federal sources (net of allowances) decreased from \$70.3 million in 2005 to \$35.5 million in 2006. Refer to Notes to the Principal Financial Statements, Note 6, for an analysis of Accounts Receivable balances. Non-Federal receivables consist of debts owed to the International Boundary and Water Commission, and amounts owed for Repatriation Loans, medical costs, travel advances, proceeds from the sale of real property, and other miscellaneous receivables.

Of the delinquent receivables over 365 days old, \$5.9 million is for the Repatriation Loan Program. These are loans given to destitute American citizens stranded overseas to allow them to return to the United States. The loans are given only if the individual cannot obtain funds from relatives, friends, employers, or another source. The Department acts as the lender of last resort. The loan becomes delinquent 60 days after repatriation to the United States. Due to their poor economic situation, most of these individuals are unable to repay the loans on time.

The Department uses installment agreements, salary offset, and restrictions on passports as tools to collect its receivables. It also receives collections through its cross-servicing agreement with the Department of the Treasury. In 1998, the Department entered into a cross-servicing agreement with the Department of the Treasury for collection of delinquent receivables. In accordance with the agreement and the Debt Collection Improvement Act of 1996 (Public Law 104-134), the Department referred \$1,673,117 to Treasury for cross-servicing in 2006.

**Receivables Referred to the Department of the Treasury for Cross-Servicing**

	FY 2006	FY 2005	FY 2004
Number of Accounts	1,044	638	253
Amounts Referred (In Thousands)	\$1,673	\$ 956	\$ 261

## FEDERAL CIVIL PENALTIES INFLATION ADJUSTMENT ACT

The Federal Civil Penalties Inflation Adjustment Act of 1990 established annual reporting requirements for civil monetary penalties assessed and collected by Federal agencies. Civil penalties are defined as any non-criminal penalty, fine or other sanction for which a given dollar amount or maximum amount is specified by Federal law, and which is assessed or enforced by an agency as a result of an administrative proceeding or civil action in the Federal courts. The Department has assessed fines on individuals and companies for exporting defense materials without required approvals and for misrepresenting facts on an export application.

COMPANY NAME	VIOLATION	DATE ASSESSED	AMOUNT ASSESSED	PAYMENT SCHEDULE
SPACE SYSTEMS/LORAL, INC.	Violating the express terms and conditions of the Department's munitions licenses and exporting defense services without a munitions license or other authorization to the People's Republic of China.	1/9/2002	\$14,000,000	\$2,200,000 initially, then \$1,685,714 for seven subsequent years
HUGHES ELECTRONICS CORP. & BOEING SATELLITE SYSTEMS	Violating the terms and conditions of the Department's munitions licenses and exporting defense services without munitions licenses or other authorizations (and conduct relating to two failed launches of rockets carrying spacecraft) to the People's Republic of China.	3/4/2003	\$12,000,000	\$1,500,000 for eight years
EDO CORPORATION	Violations incurred by Condor Systems, Inc. prior to the acquisition of business assets by EDO that included the terms and conditions of the Department's munitions license and exporting defense services without munitions license or other authorizations.	11/24/2003	\$1,750,000	\$583,334 initially, then \$583,333 for two years
ITT CORPORATION	Exporting defense articles and services (night vision products and space remote sensing technical data and defense services) in violation of the terms or conditions of other approvals that were provided by the Department.	11/1/2004	\$3,000,000	\$1,000,000 initially, then \$1,000,000 for two years
GENERAL MOTORS CORPORATION	Exporting defense articles and services (to foreign person employees of proscribed countries) in violation of the terms or conditions of other approvals that were provided by the Department.	11/1/2004	\$8,000,000	\$2,000,000 initially, then \$1,500,000 for four years
ORBIT ADVANCED TECHNOLOGIES INC.	Violating the terms and conditions of the Department's munitions and licenses by agreeing to sell defense articles (Radome Measurement System – AL8098/AL8099) to the People's Republic of China	08/29/05	\$500,000	\$33,334 initially, then \$33,333 over two years, then \$200,000 over three years
THE BOEING COMPANY	Exporting unauthorized defense articles and services (to foreign person employees of proscribed countries) in violation of the terms and conditions of the Department's International Traffic in Arms Regulations (ITAR).	03/28/06	\$15,000,000	\$15,000,000 within 10 days for complete settlement
GOODRICH CORPORATION	Exporting unauthorized defense articles and services (to foreign person employees of proscribed countries) in violation of the terms and conditions of the Department's International Traffic in Arms Regulations (ITAR).	03/28/06	\$1,250,000	\$500,000 in 10 days, then \$250,000 over three years
L-3 COMMUNICATIONS	Exporting unauthorized defense articles and services (to foreign person employees of proscribed countries) in violation of the terms and conditions of the Department's International Traffic in Arms Regulations (ITAR).	03/28/06	\$2,000,000	\$500,000 in 10 days, then \$500,000 over three years
TOTAL			\$57,500,000	

COMPANY NAME	Balance Outstanding September 30, 2005	Fiscal Year 2006 Assessments	Fiscal Year 2006 Collections	Balance Outstanding September 30, 2006
SPACE SYSTEMS/LORAL, INC.	\$ 10,114,284	\$ —	\$ 5,057,142 (Chapter 11 Bankruptcy granted January 2004)	\$ 5,057,142
HUGHES ELECTRONICS CORP. & BOEING SATELLITE SYSTEMS	\$ 5,000,000	\$ —	\$ 3,500,000	\$1,500,000
EDO CORPORATION	\$ 583,333	\$ —	\$ 583,333	\$ —
ITT CORPORATION	\$ 2,000,000	\$ —	\$ 1,000,000	\$ 1,000,000
GENERAL MOTORS CORPORATION	\$ 6,000,000	\$ —	\$ 1,500,000	\$ 4,500,000
ORBIT ADVANCED TECHNOLOGIES INC.	\$ 266,666	\$ —	\$ 33,333	\$ 233,333
THE BOEING COMPANY	—	\$ 15,000,000	\$ 15,000,000	\$ —
GOODRICH CORPRATION	—	\$ 1,250,000	\$ 500,000	\$ 750,000
L-3 CORPORATION	—	\$ 2,000,000	\$ 500,000	\$ 1,500,000
<b>TOTAL</b>	<b>\$ 23,964,283</b>	<b>\$ 18,250,000</b>	<b>\$ 27,673,808</b>	<b>\$ 14,540,475</b>

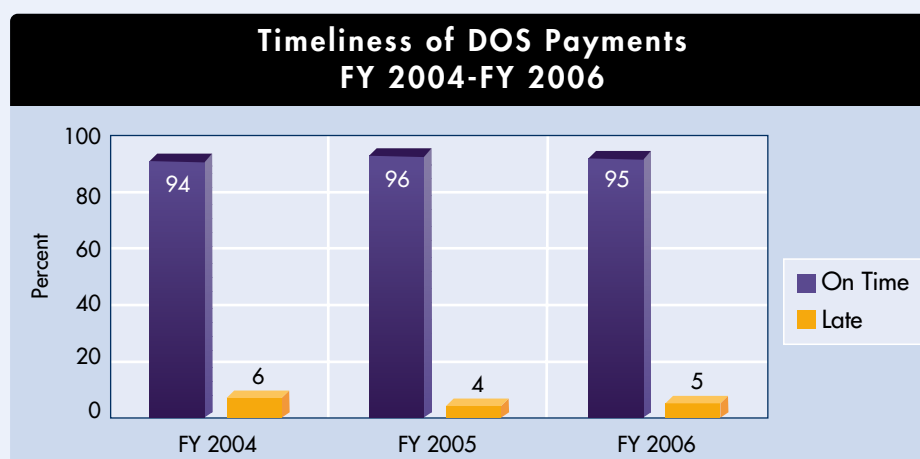


## MANAGEMENT OF PAYMENTS

### PROMPT PAYMENT ACT

#### TIMELINESS OF PAYMENTS

The Prompt Payment Act (PPA) requires Federal agencies to pay their bills on time or an interest penalty must be paid to vendors. During FY 2006, the Department made 614,511 payments subject to prompt payment of which 586,434 or 95% were paid on time. Presented below is a chart that reflects the timeliness of the Department's payments from FY 2004 through FY 2006.

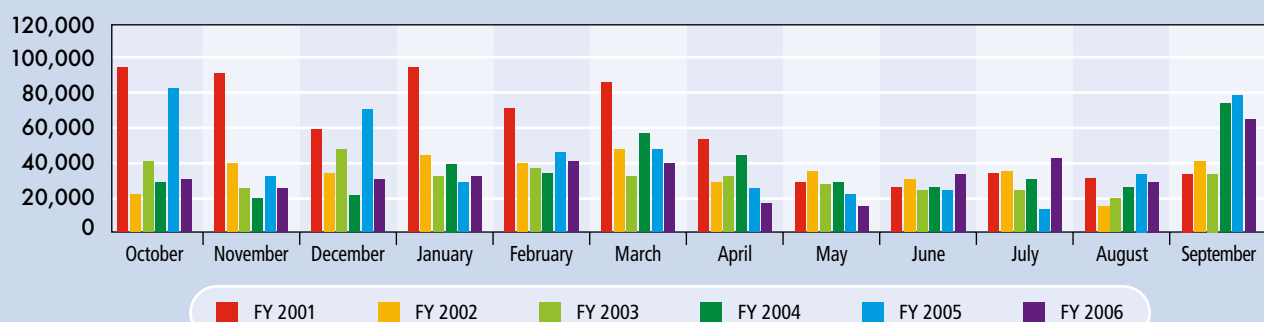


During FY 2006, 1% of invoices required interest penalties compared to 2% for FY 2005. The percentage of interest penalties paid against the total invoices amount paid for domestic payments has been steadily improving: FY 04 – 0.016%, FY 05 – 0.013%, and FY 06 – 0.009%.

#### SELECTED PAYMENT DATA

	2006	2005	2004
Interest Paid (\$000)	405	557	431
Interest Under \$1 Not Due (\$000)	—	—	—
Interest Due But Not Paid (\$000)	—	—	—
Number of Procurement Card Transactions			
Domestic	45,804	54,061	61,838
Overseas	82,023	75,407	66,416

### Domestic Prompt Payment Interest FY 2001 to FY 2006



### ELECTRONIC PAYMENTS

Payments made through Electronic Funds Transfer (EFT) were 87 percent of the total payments made for domestic and overseas payments. This is an increase of 2 percent over the fiscal year 2005 rate. EFT payments made for the Domestic operations were 98 percent of the total domestic payments. EFT payments made through the USDO for overseas operations was 81 percent of the total number of overseas payments. This is an increase of over 4 percent of the fiscal year 2005 rate. Payments made for overseas operations will not have the same rate as the domestic payments due to the result of complexities of banking operations in some of the countries where payments are made by the Department of State.

### EFT and Check Payment Volumes

Payment Type	2006		2005		2004	
	Number	Percent	Number	Percent	Number	Percent
<b>EFT:</b>						
Domestic	1,095,691	98	1,120,735	98	981,427	97
Overseas	1,455,055	81	1,309,530	77	885,623	67
EFT Subtotal	2,550,746	87	2,430,265	85	1,867,050	80
<b>Checks:</b>						
Domestic	26,869	2	23,539	2	26,012	3
Overseas	352,092	19	400,985	23	440,394	33
Checks Subtotal	378,961	13	424,524	15	466,406	20
Total Domestic	1,122,560	38	1,144,274	40	1,007,439	43
Total Overseas	1,807,147	62	1,710,515	60	1,326,017	57
<b>Total Payments</b>	<b>2,929,707</b>	<b>100</b>	<b>2,854,789</b>	<b>100</b>	<b>2,333,456</b>	<b>100</b>

## IMPROPER PAYMENTS INFORMATION ACT

The *Improper Payments Information Act of 2002* (Public Law No. 107-300) (IPIA) requires agencies to annually review their programs and activities to identify those susceptible to significant improper payments. OMB, in OMB Circular A-136, requires detailed information relating to IPIA, which is provided below.

In FY 2004, the Department identified programs that were susceptible to significant improper payments. A risk assessment was performed based on dollar volume, number of vendors or recipients, internal controls, audit reports of the programs, and management's institutional knowledge. Based on the results of this assessment, the Department classified all payments into the following three categories:

- Employee Pay
- Vendor Payments
- Federal Financial Assistance

Two types of payments were identified as having a potential high risk for significant improper payments; Federal Financial Assistance Programs and Vendor Payments. The following programs were identified as high-risk and tested in FY 2004:

**FEDERAL FINANCIAL ASSISTANCE AREA**

- International Information Programs (IIP) – U.S. Speaker and Specialist Program
- International Narcotics and Law Enforcement (INL) – Counter-narcotics Program

**VENDOR PAY AREA**

- Other Contractual Services
- Structures & Equipment (test work in this area was started in FY 2004 and completed in FY 2005)

As shown in the table below, based on the FY 2004 test results for the programs tested, only the Federal Financial Assistance IIP Program was categorized as being susceptible to significant improper payments.

**FY 2004 Improper Payments Test Results**

Year Reviewed	Payment Category	Program	First Nine Months FY 2005 Outlays	IP %	IP \$
FY 2004	Federal Financial Assistance	INL Counter-narcotics Program	\$ 313	0.87%	\$ 1.7
		IIP - U.S. Speaker and Specialist Program	\$ 30	81.18%	\$ 1.4
	Vendor Payments	Other Contractual Services	\$ 1,534	2%	\$ 0.78

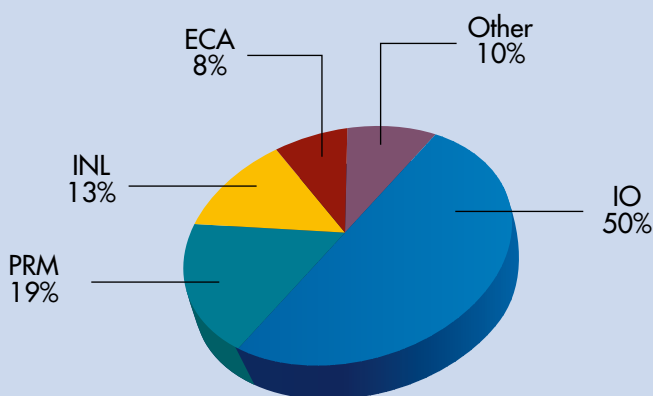
In FY 2005, a reassessment of risk was performed to determine which categories identified in FY 2004 were still susceptible to significant improper payments. Based on the results of this reassessment of risk, the following was noted:

- **Employee Pay** - Based on the Department's institutional knowledge and the results of past internal control reviews over this process, this category did not appear to be susceptible to significant improper payments in FY 2005.
- **Vendor Payments** – Based on the FY 2004 test results, this category of payments was also not considered to be susceptible to significant improper payments in FY 2005.
- **Federal Financial Assistance** - This was the only category of payments considered to be susceptible to significant improper payments in FY 2005.

As part of this reassessment, using data for the last quarter of FY 2004 and the first three quarters of FY 2005, the population of Federal Financial Assistance payments by specific programs within each bureau was identified. The following is a breakout of these expenditures by bureau:

OMB's threshold of \$10 million and 2.5% of program payments was applied to each program within the bureaus to identify those programs that could be susceptible to significant improper payments. For the programs meeting the threshold, the reassessment of risk was conducted to determine whether these programs had a High, Moderate, or Low risk of susceptibility to improper payments. In addition, three programs were identified that did not meet the OMB threshold but, based on the Department's institutional knowledge, could be susceptible to significant improper payments.

**Federal Financial Assistance Payments by Program**



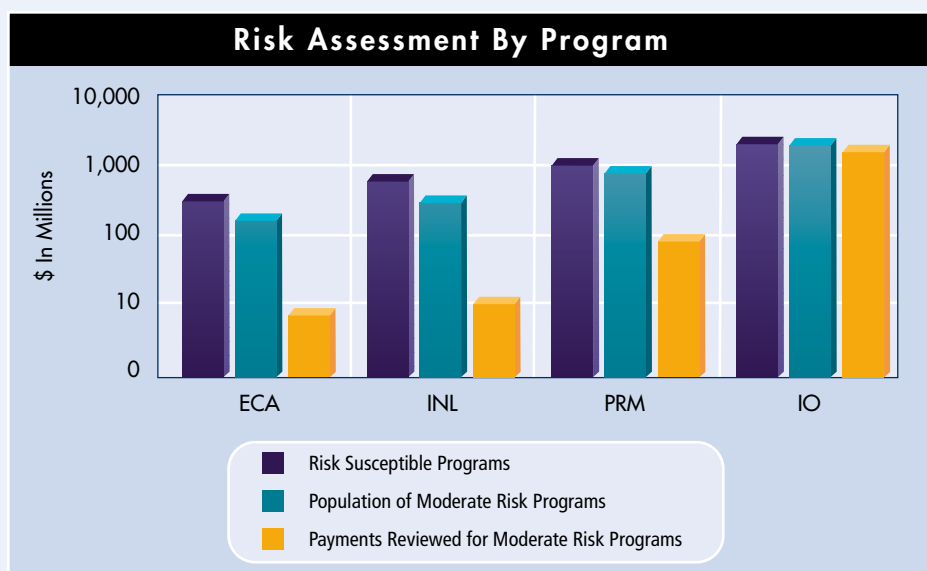
The following is a list of the programs that were classified as being susceptible to significant improper payments and the overall risk assessment for each program.

Program	Risk Assessment
<b>Educational &amp; Cultural Affairs (ECA) – Fulbright Program</b>	Moderate
ECA – Teacher Exchange*	Low
ECA – Humphrey Program*	Low
ECA – Study of the U.S.*	Low
<b>INL – Law Enforcement Support, Eradication, Aviation Support, &amp; Support to the Military</b>	Moderate
Population, Refugees and Migration (PRM) – Humanitarian Migration to Israel	Low
PRM – Refugee assistance through International Organizations	Low
PRM – Refugee Admissions	Low
PRM – Refugee Assistance (grants and contributions)	Moderate
<b>International Organizations (IO) – Contributions to International Organizations and Peacekeeping</b>	Moderate

\* Although these programs did not meet the OMB threshold, the Department identified them as being susceptible to improper payments due to the similarity in the scope of these programs to the Fulbright Program. However, based on the results of the risk assessments, these programs were classified as having a low risk of susceptibility to improper payments.

In addition, Structures and Equipment (classified under the Vendor Payments category in FY 2004) was classified as high-risk. The improper payments review for Structures and Equipment was started in FY 2004 and completed in FY 2005.

The following chart shows a breakdown of the Federal Financial Assistance dollars for the risk susceptible bureaus, the population of expenditures for moderate risk programs (identified above) for each risk susceptible bureau, and the payments reviewed for the moderate risk programs in FY 2005.



## RESULTS

One of the challenges faced during the testing of the Federal Financial Assistance Programs for improper payments is that the level of testing was performed based on the supporting documentation maintained by the Department. The Department did not extend the testing to the grantee level to obtain further supporting documentation to support whether the funds were spent in accordance with the grant agreement. As a result, the Department's testing of sampled transactions yielded an actual error rate and amount of error at zero to low levels, the results could have been different if the level of testing was extended to the grantee level.

## FY 2005 Improper Payments Test Results

Payment Category	Program	Last quarter of FY 2004 and first three quarters of FY 2005 Outlays (In Millions)	IP %	IP \$
Federal Financial Assistance	ECA - Fulbright Program	\$ 169	0.00%	\$ —
	PRM - Refugee Assistance	\$ 682	0.00%	\$ —
	IO - Contributions to International Organizations and Peacekeeping	\$ 1,891	0.00%	\$ —
Vendor Payments	Structures & Equipment	\$ 485	<1%	\$ 0.235

	ACTUAL						PROJECTED								
Program (Dollars in Millions)	Outlays	IP %	IP \$	Outlays	IP %	IP \$	Outlays	IP %	IP \$	Outlays	IP %	IP \$			
Year Reviewed: 2006															
	Last quarter of FY 2004 and first three quarters of FY 2005			FY 2006			FY 2007			FY 2008			FY 2009		
Federal Financial Assistance Programs															
* INL Narcotics Program	\$ 313	3.97%	\$180,340.00	\$ 313	3.97%	\$180,340.00	\$ 322	<1%	\$185,750.07	\$ 332	<1%	\$191,322.44	\$ 342	<1%	\$197,061.98
	First three quarters of FY 2006			FY 2006			FY 2007			FY 2008			FY 2009		
Federal Financial Assistance Programs															
IIP - U.S. Speaker and Specialist Program				\$ 28	23.81%	\$348,567.00	\$ 29	10.00%	\$361,015.82	\$ 30	<1%	\$373,464.64	\$ 31	<1%	\$385,913.46
Year Reviewed: 2005															
	Last quarter of FY 2004 and first three quarters of FY 2005			FY 2006			FY 2007			FY 2008			FY 2009		
Federal Financial Assistance Programs															
ECA - Fulbright Program	\$ 169	0.00%	\$ —	\$ 187	0.00%	\$ —	\$ 196	0.00%	\$ —	\$ 205	0.00%	\$ —	\$ 205	0.00%	\$ —
PRM - Refugee Assistance	\$ 682	0.00%	\$ —	\$ 870	0.00%	\$ —	\$ 1,009	0.00%	\$ —	\$ 1,039	0.00%	\$ —	\$ 1,039	0.00%	\$ —
IO - Contributions to International Organizations and Peacekeeping	\$ 1,891	0.00%	\$ —	\$ 1,948	0.00%	\$ —	\$ 2,006	0.00%	\$ —	\$ 2,066	0.00%	\$ —	\$ 2,066	0.00%	\$ —
Vendor Payments															
Structures & Equipment	\$ 485	<1%	\$ 0.235	\$ 691	0.00%	\$ —	\$ 712	<1%	\$ —	\$ 733	0.00%	\$ —	\$ 755	0.00%	\$ —

\* The improper payment testing for INL was started in FY05 and completed in FY06



## FY 2006 Improper Payments Test Results

In FY06, a random sample of the detailed payment transaction data was selected for the last month of FY 2004 and first three months of FY 2005 for International Narcotics and Law Enforcement (INL) and the first nine months of FY 2006 for International Information Programs-U.S. Speaker and Specialist Program (IIP). Both programs were identified as high-risk and tested in FY 2004. The sampling methodology used was developed using the OMB guidance. Test results found improper payments in both programs. The projected error rate and dollar amount of improper payments in the population sampled range from approximately 3.97 % and \$180,340 thousand to 23.97 % and \$348,567 thousand.

Program	Transactions in		Dollars in		Error Rate	Projected Improper Payments
	Population	Sample	Population	Sample		
International Narcotics and Law Enforcement- Law Enforcement, Eradication, Aviation Support and Support to the Military.	4,315	126	\$ 313,078,592	\$ 2,366,056	3.97%	\$ 180,340
International Information Programs- U.S. Speaker and Specialist Program	741	126	\$ 28,822,489	\$ 288,548	23.81%	\$ 348,567

### Calculation of error rate and payment amounts based on sample results

Actual test results and projected improper payments for Fiscal Years 2007 through are shown in the enclosed table.

### STATISTICAL SAMPLING PROCESS

Using OMB guidance, the Department assumed a 2.5 percent or less rate of error for each of the programs sampled since the Department had no historical error rate to use in calculating the sample sizes of the different populations. A sample size of 126 transactions was reviewed for each program. The sample size selected was based on the minimum required to yield an estimate with a 90% confidence level and a confidence interval of plus or minus 2.5%.

Several corrective action recommendations were made to the Office of Financial Policy, Reporting and Analysis (FPRA) in an effort to reduce the amount of the agency's improper payments and internal control deficiencies.

The following table provides a summary of the improper payments identified in FY 2006, the cause for the improper payment, the impact and corrective action plans to reduce the estimated rate of improper payments:



*The Department of State Charleston Financial Service Center.  
Department of State Photo*

Year Reviewed	Payment Category	Program	Improper Payment Findings and Impact	Corrective Actions
FY 2006	Federal Financial Assistance	IIP-U.S. Speaker and Specialist Program	Insufficient documentation provided to support eligibility for the award. Difficulty in validating grantee's eligibility without sufficient documentation.	The Department will enforce and follow its policies and procedures as it relates to proper documenting the biographical information.
			Incorrect financial assistance award instrument used to obligate award.	The Department will review all documentation prior to obligating the award in CFMS to ensure that the correct financial assistance instrument is being used.
			Overpayment.	The Department will review all documentation prior to making an award and ensure that an award is being made from the correct supporting documentation
		INL-Law Enforcement, Eradication, Aviation Support and Support to the Military	Insufficient supporting documentation. Difficulty in validating the payment.	The Department will enforce and follow policies and procedures as it relates to maintaining sufficient documentation.
			Prompt Payment Act Violation Cannot validate grantees eligibility without sufficient documentation. Inconsistency in annotating the date of receipt on invoices potentially resulting in overpayment or underpayment of interest.	The Department will enforce policies and procedures as it relates to clearly annotating the date the invoice is received.

## RECOVERY AUDIT PROGRAM RESULTS

Currently the Department of State, Bureau Resource Management, has in place a detection and recovery program to monitor duplicate and erroneous payments. This is a monthly audit of all payments focusing on identifying potential erroneous and duplicate domestic payments. Using data mining software to identify potential duplicate and erroneous payments, payments are validated, and then collection begins. In addition, there is an established debt management support structure, specifically focused on early detection, identification and collection of erroneous and duplicate commercial claims.

For FY 2006, there were 591 (or 0.15%) out of 403,636 payments identified as potential duplicate/erroneous payments. Of these, 259 were confirmed duplicate payments totaling approximately \$2.3 million out of \$10 Billion. Of the 259 confirmed duplicate payments, 214 have been collected totaling \$2.15 million while 45 remain outstanding totaling \$120,450. The cause of the improper payments caused by obligations being recorded to an incorrect vendor and authorized payments to the same claim from multiple funding strips. The Department is committed to reducing erroneous payments issued domestically and overseas. Programs and procedures have been instituted that will strengthen agency management and internal control procedures for prevention, detection and recovery of erroneous payments. The following improvements are being undertaken: Issue updated guidance for performing program reviews and risk assessments. Strengthen policies and procedures with regard to proper documentation requirements for payments. Provide training to affected staff regarding proper payment requirements and documentation. Strengthen payment and debt management programs, policies and practices that will improve detection, referral and recovery efforts

The cost to run the internal CFSC's (Global Financial Services) erroneous payment program is estimated at approximately \$135,000. In addition, a recovery audit firm was used during the fiscal year. The cost associated with the contracted recovery audit firm was approximately \$30,000 which was paid out of the funds recovered.

U.S. DEPARTMENT OF STATE DEBT RECOVERY PROGRAM									
Audit Program	Amount of Payments Subject to Review	Number of Payments Reviewed	Number				Amount (in \$000)		
			Potential Duplicates	Actual Duplicates Confirmed	Claims Collected	Outstanding Claims	Duplicate Payments Confirmed	Duplicate Payments Collected	Outstanding Claims
Recovery Auditor	\$8.4 Billion	419,688	80	26	26	0	\$ 127.7	\$ 127.7	\$ 0.0
Internal CFSC Audit	\$26.5 Billion	403,636	591	259	214	45	\$ 2,269.5	\$ 2,149.0	\$ 120.5
Total	\$34.9 Billion	823,324	671	285	240	45	\$ 2,397.2	\$ 2,276.7	\$ 120.5

## ACCOUNTABILITY

The Department is committed to reducing erroneous payments issued domestically and overseas. Programs and procedures have been instituted that will strengthen agency management and internal control procedures for prevention, detection and recovery of erroneous payments. The following improvements are being undertaken:

- Issue updated guidance for performing program reviews and risk assessments
- Strengthen policies and procedures with regard to proper documentation requirements for payments
- Provide training to affected staff regarding proper payment requirements and documentation
- Strengthen payment and debt management programs policies and practices that will improve detection, referral and recovery efforts
- Report information on improper payments in the annual *Performance and Accountability Report*

## INFORMATION SYSTEMS

Based on the improper payment reviews conducted in FY 2005 and FY 2006, the improper payments identified did not result from the lack of proper information systems. Although the Department is currently in transition to implement a global financial management system by FY 2007, the current financial management system did not have an impact on the level of improper payments identified.

## ISSUES

As previously mentioned, one of the challenges the Department faced in FY 2006 was determining to what extent federal financial assistance should be tested to obtain reasonable assurance that improper payments are not occurring at the grantee level. The Department performed limited procedures to test for improper payments that did not involve reviewing payments at the grantee level. However, to supplement the test work performed, the Department relied on monitoring procedures performed at the program offices, the A-133 reports of grantees, and the results of OIG reviews. In FY 2007, the Department will consider establishing procedures in the Bureau of Resource Management to monitor financial transactions. The Department will also seek guidance from OMB in FY 2006 to determine the most feasible way to test federal financial assistance for compliance with the IPIA. The Department will also review best practices to follow in FY 2007.

## MANAGEMENT OF AUDIT FOLLOW-UP

The information on the Department's follow-up on audit recommendations covers FY 2006. It includes information on the status of recommendations more than one year old without final management decisions as of September 30, 2006. It also includes the dollar value of resolved recommendations in which funds could be put to better use or "*questioned costs*," as of September 30, 2006.

As of September 30, 2006 there were 22 audit reports that had 47 recommendations resolved without final management decisions that were more than one year old.

Management Statistical Summary 22 Audits Over One Year Old Requiring Final Action		
Program Area	Number of Audit Reports	Recommendations
Financial Management	11	33
Information Management	—	—
Security Oversight	3	4
International Programs	1	1
Property Management and Procurement	2	4
Contracts and Grants	<u>5</u>	<u>5</u>
<b>TOTALS</b>	<u><b>22</b></u>	<u><b>47</b></u>

## Status of Audits with Recommendations that Funds Be Put to Better Use and Questioned Costs

**Funds Put to Better Use.** On October 1, 2005, there were two (2) audit reports with resolved recommendations to put \$23,549,000 of funds to better use:

- AUD/IQO-05-13, issued 2/8/2005, \$21,749,000. During FY 2006, Management disagreed and the OIG closed it on 3/15/06.
- AUD/PPA-04-22, issued and resolved on 4/19/2004 \$1,800,000 FPTBU and Management agreed with it on 4/27/2006.

Two (2) audit reports were issued during FY 2006 with recommendations for "better used funds" that were resolved without management decision totaling \$9,701,783. One (AUD/PP-06-08) of the two audit reports with a \$1.1 Million recommendation was implemented and closed during FY 2006.

Therefore the balance of open recommendations related to "funds put to better use" at the end of FY 2006 was **\$8,601,783**.

**Questioned Costs.** On October 1, 2005, there were seven (7) audits with resolved recommendations with questioned costs valued at \$3,746,953. During the year, four (4) audits were issued that had \$2,245,871 of questioned cost recommendations that also were resolved without management decision on 9/30/06.

During FY 2006, management made final decisions and disallowed \$538,278 (related to 4 of the 11 reports) and allowed \$2,296,415 (related to 2 of the 11 reports). Therefore the balance of open recommendations related to "questioned costs" at the end of FY 2006 was **\$3,158,131**.

Summary of Resolved Recommendations with Either Funds Put To Better Use (FPTBU) or Questioned Costs				
	Number of Audit Reports Identifying FPTBU	Dollar Value of FPTBU	Number of Audit Reports Identifying Questioned Costs	Dollar Value of Questioned Costs
Beginning Balance 10/1/05	2	\$23,549,000	7	\$3,746,953
Issued during FY 2006	2	+\$9,701,783	4	+\$2,245,871
Implemented Actions During FY 2006 by Department	<u>3</u>	<u>(\$24,649,000)</u>	<u>6</u>	<u>(\$2,834,693)</u>
Outstanding Ending Balance 9/30/06	<u>1</u>	<u>\$8,601,783</u>	<u>5</u>	<u>\$3,158,131</u>

## FINANCIAL PERFORMANCE METRICS

Below is a year-end summary provided to senior managers of the Department's performance relative to the Chief Financial Officers (CFO) Council financial metrics. Because of the unique aspects of operating in both a domestic and overseas environment, the Department adjusts these metrics were appropriate to reflect a measure for domestic operations and a separate indicator for overseas performance. A good example of this would be *Percent of Vendor Payments Made by EFT* where the domestic percentage target would be higher than the overseas target to convey the differences in the overseas banking systems ability to handle EFT transactions.

For FY 2006, the Department's financial metrics improved to green in one category and remained constant in the others. The Government-wide metrics are as of June and July FY 2006.

Measure and Frequency	Why Is It Important	State Sept 2006		State Sept 2005		Governmentwide Performance Standards			Governmentwide June/July 2006	
		Actual	Rating	Actual	Rating	Fully Successful	Minimally Successful	Unsuccessful	Actual	Rating
Fund Balance With Treasury - Net Percent Unreconciled [Monthly]	Smaller reconciliation differences translate to greater integrity of financial reports and budget results.	0.90%		2.90%		< = 2%	> 2% to < = 10%	> 10%	0.1247%	
Percent of Amount in Suspense (Absolute) Greater than 60 Days Old [Quarterly]	Timely reconciliation supports clean audits and accurate financial information.	90.00%		83.10%		< = 10%	> 10% to < = 20%	> 20%	60.90%	
Percent of Accounts Receivable from Public Delinquent Over 180 Days [Quarterly]	Actively collecting debt improves management accountability and reduces Treasury borrowing.	40.70%		27.20%		< = 10%	> 10% to < = 20%	> 20%	13.63%	
Percent of Vendor Payments made Electronically [Monthly]	Use of electronic funds transfer saves money, reduces paperwork, and improves cash management.	95.40%		96.00%		> = 96%	> = 90% to < 96%	< 90%	95.61%	
Percent Non-Credit Card Invoices Paid On-Time [Monthly]	Timely payment reduces interest charges and reflects a high degree of accountability and integrity.	79.40%		90.00%		> = 98%	> = 97% to < 98%	< 97%	96.06%	
Interest Penalties Paid as a Percent of Total Payments [Monthly]	Smaller percentages of interest paid shows that an agency is paying its bills on time which saves money and allows funds to be used for their intended purpose.	0.0100%		0.0163%		< = .02%	> .02 to < = .03%	> .03%	0.0141%	
Travel Card Delinquency Rates - Individually Billed Accounts [Monthly]	Reducing outstanding travel card balances helps increase rebates to agencies.	2.30%		2.30%		< = 2%	> 2% to < = 4%	> 4%	3.16%	
Travel Card Delinquency Rates - Centrally Billed Account [Monthly]	Reducing outstanding travel card balances helps increase rebates to agencies.	0.90%		0.90%		= 0%	> 0% to < = 1.5%	> 1.5%	1.17%	
Purchase Card Delinquency Rate [Monthly]	Reducing outstanding purchase card balances helps increase rebates to agencies and reduces interest payments.	0.88%		0.88%		= 0%	> 0% to < = 1.5%	> 1.5%	0.98%	



## HISTORICAL NOTES ON U.S. DIPLOMACY

### DIPLOMACY'S BEST DEAL

In 1803, two U.S. diplomats, American Minister to France Robert Livingston and Special Negotiator James Monroe, concluded the largest real estate transaction ever when they secured the entire territory of Louisiana for the United States. Although Livingston and Monroe exceeded the orders of President Thomas Jefferson—and their spending limit—the deal was too good to pass up. As Livingston reported, the French Treasury Secretary urged him to “Consider...the importance of having no neighbors to dispute you, no war to dread.” The Americans did, and two weeks later on April 30, 1803, the French agreed to sell the entire territory for the bargain price of \$15 million.

### DIPLOMACY AND THE TELEGRAPH

At the end of the Civil War in 1865, diplomatic reports to and from our missions abroad moved at the pace of ships crossing the ocean. But everything changed the following year with the completion of the transatlantic cable linking the United States and Europe. Just a few months later, the Department of State established a telegraphic office to handle the important new messages. Although diplomats learned to write more concisely, the Department warned that it was expensive and not to be used “except when justified by the importance and urgency of the case...” Diplomats took the message to heart and trimmed their prose accordingly. In 1881, the U.S. Minister to Russia, John W. Foster, earned the distinction of sending the shortest diplomatic dispatch. “Emperor Dead,” he wrote. No one since has crafted a more concise cable.